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In The

Supreme Court of the United States

OCTOBER TERM, 1982

IN RE INTERNATIONAL HARVESTER COMPANY and IH STEEL CORPORATION, **Petitioners.**

PETITION FOR WRITS OF PROHIBITION AND MANDAMUS TO THE UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF ILLINOIS AND THE UNITED STATES BANKRUPTCY COURT FOR THE NORTHERN DISTRICT OF ILLINOIS

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February 16, 1983

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QUESTIONS PRESENTED

Following this Court's decision in *Northern Pipeline Construction Co.* v. *Marathon Pipe Line Co.*, 102 S. Ct. 2858 (1982), and Congress' failure to enact remedial legislation:

1. Do the United States District Courts have jurisdiction over bankruptcy matters?

2. May the United States District Courts validly refer bankruptcy proceedings involving state law claims to bankruptcy judges?

LIST OF PARTIES

Petitioners are International Harvester Company, a Delaware corporation with its principal place of business in Illinois, and IH Steel Corporation, an Illinois corporation with its principal place of business in Illinois. Publicly held affiliates of petitioners are International Harvester France, Establissements Louis Bouilloux, Harbour Underwriting Agency Ltd., Harco Holdings Inc., International Harvester Mexico, S.A., and Soilmaster Limited.

The courts against whom the writs are sought are: The United States District Court for the Northern District of Illinois, Frank J. McGarr, Chief Judge, and the United States Bankruptcy Court for the Northern District of Illinois, Charles B. McCormick, Presiding Judge.

The other parties are Wisconsin Steel Co., WSC Corp., WSC Sales Inc., WSC Shipping Inc., Envirodyne Transportation Co., Envirodyne Stock Co., EDC Holding Co., and EDC, Inc., all Debtors-counterclaimants who initiated the adversary proceeding against petitioners; Roger E. Anderson, Karl D. Bays, Andrew F. Brimmer, William B. Callahan, Mary Garst, James J. Doyle, Arthur G. Hansen, George E. Keck, Joseph B. Lanterman, Brooks McCormick, Louis W. Menk, Graham J. Morgan, Keith R. Potter, John T. Rettaliata, Harold Byron Smith, Edson W. Spencer, T. M. Thompson and Omer G. Voss, all co-defendants with petitioners in the adversary proceeding below.

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PETITION FOR WRITS OF PROHIBITION AND MANDAMUS TO THE UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF ILLINOIS AND THE UNITED STATES BANKRUPTCY COURT FOR THE NORTHERN DISTRICT OF ILLINOIS

JURISDICTION

The United States District Court for the Northern District of Illinois entered a General Order on December 20, 1982 providing that, by rule of court effective December 25, 1982, all cases pending before the Bankruptcy Court of the Northern District of Illinois are referred by the District Court to the bankruptcy judges in the district. The local rule further prescribes the powers of the bankruptcy judges and the procedures to be followed by them in handling these cases. Petitioners invoke the jurisdiction of this Court under 28 U.S.C. § 1651(a) to review the validity of this local rule.

STATUTES AND RULES INVOLVED

Bankruptcy Reform Act of 1978 Pub. L. No. 95-598, 92 Stat. 2549 (1978).

§ 241(a)
§ 401(a)
§ 404(a)

§ 405(c)(2)
11 U.S.C. § 105
28 U.S.C. § 332(d)
28 U.S.C. § 1331
28 U.S.C. § 1332
28 U.S.C. § 1334
28 U.S.C. § 1334 (effective April 1, 1984)
28 U.S.C. § 1651(a)
Rule 26 of Rules of Sup. Ct.
Rule 53 of F.R.C.P.
Rule 82 of F.R.C.P.
Rule 83 of F.R.C.P.
Rule 513 of R.Bankr.Pro.
Rule 927 of R.Bankr.Pro.
Rule 928 of R.Bankr.Pro.

The text of these provisions is reproduced in the appendix.

STATEMENT OF THE CASE

Following this Court's decision in *Northern Pipeline*, the Judicial Conference of the United States, acting through the Administrative Office of the United States Courts, formulated and distributed to the lower federal courts draft model rules in the event that the stay of *Northern Pipeline* expired without congressional action. (App. 10 & 16) The Judicial Council of the Seventh Circuit on December 23, 1982, entered an order directing that all district courts within the circuit adopt the proposed rule or one which was "substantially similar." (App. 9) Prior to the Judicial Council's order, the United States District Court for the Northern District of Illinois on December 20, 1982, adopted the local rule which is the subject of this petition and which is modeled upon the Judicial Conference's draft rule. (App. 3) Petitioners seek writs of prohibition and mandamus invalidating the District Court's local rule as an unconstitutional act beyond the jurisdiction of either the District or the Bankruptcy Courts.

Just as in *Northern Pipeline*, this adversary proceeding arises out of the Bankruptcy Court's exercise of jurisdiction over state law claims. The bankruptcy proceedings here began in March 1980 when a group of companies affiliated with Envirodyne Industries, Inc. (Envirodyne companies) filed petitions in bankruptcy. Petitioners' involvement in those proceedings derived from the purchase of International Harvester Company's (Harvester) Wisconsin Steel Division by the Envirodyne companies in 1977.

After the Envirodyne companies filed their petitions in bankruptcy, Harvester filed a claim as a creditor in the Bankruptcy Court. Debtors collectively counterclaimed against petitioners, in an adversary proceeding, raising four counts under Illinois law alleging fraud and intentional tortious injury. Three other counts request that alleged preferences or fraudulent conveyances after the 1977 sale be set aside. Defendants Harvester and IH Steel Corporation (a wholly-owned Harvester subsidiary) moved to dismiss the four counts based on state law for failure to state a claim. Bankruptcy Judge McCormick denied this motion on November 18, 1982. (App. 24) Defendants moved for leave to appeal that Order on December 3, 1982.[1]

Meanwhile, this Court's stay of *Northern Pipleline* expired and the Northern District of Illinois adopted its local rule referring all bankruptcy cases to the bankruptcy judges in the district. At the time the stay expired, petitioners' application for leave to appeal Judge McCormick's Order of November 18, 1982 was pending in the district court. Therefore, petitioners moved on January 3, 1983, in the district court, to dismiss the counterclaim for lack of subject matter jurisdiction. District Judge Leighton, on January 7, 1983, denied leave to appeal the November 18, 1982 Order and declined to consider the jurisdictional issue, noting that the matter "remains in the bankruptcy court." (App. 36)

[1] A more detailed description of the procedural history and underlying allegations of the counterclaim is set forth in Judge McCormick's Order of November 18, 1982. (App. 24)

Pursuant to the local rule, the adversary proceeding was referred to Bankruptcy Judge McCormick. Defendants, on January 24, 1983, moved in the Bankruptcy Court to dismiss the proceeding for lack of subject matter jurisdiction. Bankruptcy Judge McCormick stated from the bench on February 14, 1983 that he will follow the local rule.

Petitioners seek writs of prohibition and mandamus prohibiting the United States District Court and the Bankruptcy Court for the Northern District of Illinois from exercising any jurisdiction in the adversary proceeding against petitioners and commanding said courts to refrain from enforcing the local rule in that proceeding.

REASONS FOR GRANTING THE WRITS

In spite of an extension of time, Congress allowed the December 24, 1982 stay of this Court's mandate in *Northern Pipeline* to expire without "reconstituting" the jurisdiction of the bankruptcy courts or establishing "other valid means of adjudication." District court orders, like that challenged here, have been entered throughout the country. Because of the lack of statutory authorization, those orders are without jurisdictional foundation.

Parties to bankruptcy proceedings throughout the country have challenged the authority of the bankruptcy judges to act in the wake of this jurisdictional void. Some lower courts have upheld local rules, similar to the one in issue here. Others have found parallel local rules invalid. This divergence of opinion has created chaos and uncertainty in bankruptcy matters.

We urge this Court to hear this petition either separately or jointly with No. 82-1242, filed January 24, 1983 by three plaintiffs in an adversary proceeding in the *Manville* bankruptcy proceeding. If this Court finds that the district courts have some form of subject matter jurisdiction over bankruptcy matters, a prompt decision is needed to return the bankruptcy courts to some semblance of normal business that

will not be undone by future rulings. If this Court finds, as we believe it will, that no jurisdictional basis exists for the local rules under which the district courts are now acting, that message must be delivered loudly and clearly to the district courts. In this matter of public importance, the stopgap jurisdiction by administrative fiat currently being utilized cannot be allowed to continue.

I. Extraordinary Circumstances Warrant That This Court Grant Writs of Prohibition And Mandamus.

The All Writs Act, 28 U.S.C. § 1651(a), empowers this Court to "issue all writs necessary or appropriate in aid" of its jurisdiction. Pursuant to this Court's Rule 26, "exceptional circumstances" exist here, the writ "will be in aid of the Court's appellate jurisdiction" and "adequate relief" cannot be had elsewhere.

A. Exceptional Circumstances Warrant Granting The Writs.

It is "precisely" within this Court's power to invoke the All Writs Act when "a court has no judicial power to do what it purports to do—when its action is not mere error but usurpation of power." *De Beers Mines* v. *United States*, 325 U.S. 212, 217 (1945). Writs of mandamus and prohibition are appropriate when "a question of public importance is involved, or where the question is of such a nature that it is peculiarly appropriate that such action by this Court be taken." *Ex Parte Peru*, 318 U.S. 578, 585 (1943); *Ex Parte United States*, 287 U.S. 241, 249 (1932).

The exercise of jurisdiction by the bankruptcy judges pursuant to the local rule is a "usurpation of power" in derogation of this Court's decision in *Northern Pipeline* and the fundamental principles of federal jurisdiction. When the lack of jurisdiction "is so clear," instead of allowing cases "to run their slow course to final decree, with inevitably futile result, the writ of prohibition should be issued as prayed." *Ex Parte New York*, 256 U.S. 490, 503 (1921).

The flurry of cases that have already been decided since the stay of *Northern Pipeline* expired on December 24, 1982 show that the lower courts are hopelessly split. Some uphold the stopgap jurisdiction suggested by the Judicial Conference.[2] Others find that no bankruptcy jurisdiction exists in either the district courts or the bankruptcy courts.[3] Still others limit the effect of *Northern Pipeline* to bankruptcies filed after the stay expired.[4] With "in excess of 500,000 bankruptcy cases" and "billions of dollars in creditors' claims"[5] at stake, the chaos and confusion in the courts

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[2] Among the cases that have found the current exercise of jurisdiction valid are: *Prudential Ins. Co.* v. *Stouffer Corp. (In re Northland Point Partners)*, No. 82-5387-W, Adv. Nos. 82-2277-W & 82-2332-W (E.D. Mich. Jan. 7, 1983) (not reported); *Walter E. Heller & Co.* v. *Matlock Trailer Corp. (In re Matlock Trailer Corp.)*, No. 382-2778, Adv. No. 382-755 (Bankr. M.D. Tenn. Jan. 26, 1983) (not reported); *Docter* v. *Gleicher (In re Stillman)*, No. 81-1-964, Adv. No. 82-73A (Bankr. D. Md. Jan. 13, 1983) (not reported); *GAF* v. *Johns-Manville Corp. (In re Johns-Manville Corp.)*, No. 82-B-11656, Adv. No. 82-6221A (Bankr. S.D.N.Y. Jan. 10, 1983) (not reported); *Stonitsch* v. *Strick Lease, Inc. (In re Isis Foods, Inc.)*, 9 Bankr. Ct. Dec. (CRR) 1291 (Bankr. W.D. Mo. Jan. 5, 1983); *Bank of Exeter* v. *Brown (In re Brown)*, 9 Bankr. Ct. Dec. (CRR) 1276 (Bankr. W.D. Mo. Jan. 5, 1983). All cases identified as not reported have been lodged with the Clerk of Court.

[3] See pp. 12-13, *infra*.

[4] *Walter E. Heller & Co.* v. *Matlock Trailer Corp. (In re Matlock Trailer Corp.)*, No. 382-2778 Adv. No. 382-0755 (Bankr. M.D. Tenn. Jan. 26, 1983) (not reported), held that the jurisdictional vacuum created by *Northern Pipeline* affects only those cases filed after December 24, 1982. A persuasive refutation of *Matlock* is contained in *Gillman* v. *Preston Family Inv. Co. (In re Richardson)*, No. 82C-736, Adv. No. 82PC-746, slip op. 4-18 (D. Utah Feb. 7, 1983) (not reported).

[5] House Comm. on Judiciary, *Bankruptcy Court Act of 1982*, H.R. Rep. No. 807, 97th Cong., 2d Sess. 2 (1982) (hereinafter cited as "H.R. Rep. No. 807").

undermine "the certainty essential to the conduct of commercial transactions".[6] The issue presented by this petition is one of compelling "gravity and public importance" to the economic welfare of the entire nation. *See Ex Parte United States*, 287 U.S. at 249.

B. The Writs Will Be In Aid Of The Court's Appellate Jurisdiction.

It has long been recognized that "this Court has full power in its discretion to issue" extraordinary writs "to a federal district court, although the case be one in respect of which direct appellate jurisdiction is vested in the circuit court of appeals—this Court having ultimate discretionary jurisdiction by certiorari." *Ex Parte Peru*, 318 U.S. 578, 584-85 (1943); *Ex Parte United States*, 287 U.S. 241, 248-49 (1932). Thus, a writ is "in aid of the appellate jurisdiction," when the matter falls within this Court's "ultimate power . . . to review the case itself by certiorari." *Ex Parte United States*, 287 U.S. at 246. *Accord Federal Trade Commission* v. *Dean Foods*, 384 U.S. 597, 603-04 (1966).

The local rule here, adopted pursuant to direction of the Judicial Conference and the Judicial Council of the Seventh Circuit, is a clear "exercise of judicial power" and is subject to the appellate jurisdiction of this Court. *Chandler* v. *Judicial Council*, 398 U.S. 74, 96 (1970) (Harlan, J., concur). In *Chandler*, Justice Harlan found that an order of the Judicial Council of the Tenth Circuit, which directed that Judge Chandler not be assigned cases, was reviewable under

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[6] Statement of M. Drabkin Before the Subcommittee on Monopolies and Commercial Law, House Comm. on Judiciary, 98th Cong., 1st Sess. (February 2, 1983) (App. 37).

28 U.S.C. § 1651(a), even absent any prior challenge in the lower federal courts:[7]

> An order by the Council to a district judge, directing his handling of one or many cases in his court, is an integral step in the progress of those cases from initial filing to final adjudication. Like the district judge's own orders setting a time for discovery or trial, or transferring a case to another district pursuant to 28 U.S.C. § 1404(a), such an order, even though concerned with a matter of "judicial administration," is part of the official conduct of judicial business.

Id. at 105-06. If a Judicial Council's withdrawing cases from Judge Chandler is subject to review under 28 U.S.C. § 1651(a), surely the delegation of jurisdiction involved here is likewise reviewable.

C. Adequate Relief Is Not Available In Any Other Form Or From Any Other Court.

The local rule was adopted in the District Court for the Northern District of Illinois by direction of the full court. (App. 3). It was consonant with an order of the Judicial Council of the Seventh Circuit, on which all eight active Judges of the Seventh Circuit Court of Appeals sit. (App. 9). It would thus be senseless to require petitioners to pursue "their slow course to final decree," in the intermediate courts, "with inevitably futile result[s]." *Ex Parte New York*, 256 U.S. 490, 503 (1921).

The exercise of this Court's appellate jurisdiction is particularly necessary in view of the far reaching effects of the present uncertainty. This Court has recognized that when an issue arises that affects the "district courts generally . . . the writ may well issue from this court in order to expedite the settlement of the important question involved." *Ex Parte*

[7] The majority opinion in *Chandler* reached the merits of the petition without deciding whether review of the Judicial Council's order was within the Court's appellate jurisdiction. *See* 398 U.S. at 89.

United States, 287 U.S. 241, 249 (1932). A petition to this Court for an extraordinary writ is especially appropriate when "a *practice* ha[s] been adopted by district judges, as to the order or procedure in hearing causes." *Los Angeles Corp.* v. *James*, 272 U.S. 701, 706 (1927) (emphasis added). Thus, this case is one in which it is "peculiarly appropriate" for the Court to issue an extraordinary writ. *Ex Parte Peru*, 318 U.S. at 585.

II. The District Courts Have No Jurisdiction Over Bankruptcy Cases

At the threshold, the validity of the local rule in this and other districts depends upon the district courts' possessing some residual jurisdiction over bankruptcy cases after *Northern Pipeline*. There is no such residual jurisdiction.

A. *Northern Pipeline* Invalidated District Court As Well As Bankruptcy Court Jurisdiction Over Bankruptcy Matters Derived from the Bankruptcy Reform Act of 1978.

1. The opinions in *Northern Pipeline* invalidated the entire jurisdictional grant contained in the 1978 Act.

On June 28, 1982 the Court ruled in *Northern Pipeline* that Section 241(a) of the Bankruptcy Reform Act of 1978 (Public Law 95-598), was unconstitutional because it conferred jurisdiction of all cases under Title 11 on the district courts and then directed the bankruptcy court in each district to "exercise all of the jurisdiction conferred by this section on the district courts." *See* 28 U.S.C. § 1471.[8] By conferring judicial power on bankruptcy judges whose salary could be reduced

[8]Section 1471, which states the jurisdiction granted to the district courts and the bankruptcy courts, provides in relevant part:

> (a) Except as provided in subsection (b) of this section, the district courts shall have original and exclusive jurisdiction of all cases under Title 11.

(footnote continued on next page)

and who are not appointed for life, Section 241(a) violated Article III of the Constitution, which requires that the "judicial power of the United States" be exercised only by judges appointed for life whose compensation cannot be reduced while in office. A majority of the Court in *Northern Pipeline* recognized that the effect of that decision was to invalidate § 1471's entire jurisdictional grant to both the bankruptcy and district courts.

Writing for the plurality, Justice Brennan stated that, having determined that "at the least, the new bankruptcy judges cannot constitutionally be vested with jurisdiction to decide this state-law contract claim against Marathon," it was necessary to invalidate § 1471's entire grant of jurisdiction. 102 S. Ct. at 2880 n.40. He observed that the Reform Act of 1978 had entailed "a comprehensive restructuring of the bankruptcy laws." *Id.* Under the restructured Act, jurisdiction over all bankruptcy cases and matters related to such cases was granted "pursuant to a single statutory grant of jurisdiction." *Id.* That single statutory grant disclosed an "express" congressional intent that all claims related to bankruptcy matters—both those traditionally within the bankruptcy court's jurisdiction and those state-law claims that had been added by the 1978 Act—be adjudicated "in a single forum." *Id.* Given that legislative history, the plurality could not sever the unconstitutional portion of the grant from the remaining portions of § 1471; it was impossible to determine from the 1978 Act what jurisdictional framework

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(footnote continued from preceding page)

(b) Notwithstanding any Act of Congress that confers exclusive jurisdiction on a court or courts other than the district courts, the district courts shall have original but not exclusive jurisdiction of all civil proceedings arising under Title 11 or arising in or related to cases under Title 11.

(c) the bankruptcy court for the district in which a case under Title 11 is commenced shall exercise all of the jurisdiction conferred by this section on the district courts.

Congress might have intended in the absence of the "single statutory grant of jurisdiction." *Id.* Rather, the plurality found that "it is for Congress to determine the proper manner of restructuring the Bankruptcy Act of 1978 to conform to the requirements of Art. III, in the way that will best effectuate the legislative purpose." *Id.* The plurality thus struck down all of § 1471's grant of jurisdiction.

Justice Rehnquist's concurring opinion, joined in by Justice O'Connor, agreed with the plurality that the portion of § 1471 which involved an unconstitutional grant of jurisdiction to the Bankruptcy Courts "is not readily severable from the remaining grant of authority," contained in § 1471. *Id.* at 2882. Because of this nonseverability, Justices Rehnquist and O'Connor joined the plurality in invalidating all of § 1471.

Although dissenting, Justice White (joined by Chief Justice Burger and Justice Powell) also recognized that the effect of *Northern Pipeline* was to eliminate the entire jurisdictional grant of § 1471. Thus, Justice White's dissent objected to the majority's "inexplicably heavy hand." *Id.* at 2888. Although he believed that the Court should have attempted to sever the unconstitutional grant from the rest of § 1471, Justice White acknowledged that that was not the effect of the decision. *Id.*[9]

2. The lower courts are split, with many interpreting *Northern Pipeline* as invalidating the entire jurisdictional grant of the 1978 Act.

Some lower courts, after *Northern Pipeline*, have upheld bankruptcy jurisdiction of district courts and bankruptcy

[9]Chief Justice Burger, who took a more narrow view of the scope of *Northern Pipeline*, recognized, at the very least, that bankruptcy court jurisdiction over state law claims would require a new statutory enactment by Congress. *Id.* at 2882. Thus the entire Court determined that new congressional action would be necessary before the bankruptcy courts could exercise jurisdiction over state law bankruptcy claims such as those in issue in this adversary proceeding.

courts. Others have concluded that no jurisdiction exists in either the district courts or the bankruptcy courts. In *In re Motion to Dismiss: Constitutionality of Jurisdiction of the Bankruptcy Court*, 23 B.R. 334 (Bankr. N.D. Ga. 1982), Judge Norton held that both the bankruptcy courts and district courts would lack jurisdiction over Title 11 cases once the *Northern Pipeline* stay expired. He observed that:

> The plurality observed that all of § 241(a) jurisdiction originally granted by 28 U.S.C. § 1471(a) and (b) to the District Court was a "facade" as it had been effectively vested exclusively in the Bankruptcy Court, and the District Court had no Title 11 trial jurisdiction to exercise. Hence, the stay was a practical necessity without which no trial court had any authority after June 28, 1982 to exercise jurisdiction over Title 11 cases and proceedings. (*Id.* at 338)

Judge Norton further noted that no district court jurisdiction existed to fill the void:

> The legislative history of the development of the 1978 Act reveals clearly that the Act never intended the District Court to be vested with or exercise in fact any Title 11 trial jurisdiction. (*Id.* at 345)

Under those circumstances, once the stay of *Northern Pipeline* expired, "the District Court has no authority to retain, to transfer or to remand the case or proceeding. *It has only the authority to dismiss for lack of jurisdiction.*" *Id.* at 346 (emphasis added).

In *In re Schear Realty & Investment Co.*, 1983 Bankr.L. Rep. (CCH) ¶ 68,949 (Bankr. S.D. Ohio December 27, 1982), Judge Anderson dismissed a state law foreclosure suit for lack of subject matter jurisdiction. Consistent with *Northern Pipeline* and in *In re Motion to Dismiss*, Judge Anderson concluded that it was contrary to the legislative intent behind § 1471 to assume that the District Court retained any bankruptcy

jurisdiction once the Bankruptcy Court's exercise of that jurisdiction was found unconstitutional:

> There can be little doubt that no Article III jurisdiction was conferred by 28 U.S.C. § 1471 on District Judges. The legislative device of constituting an independent Bankruptcy Court as "adjuncts" of the District Court was found to be unconstitutional and a "facade" not vesting any real jurisdiction in the District Court. (*Id.* at 81,626)

Thus, "in the absence of legislative authorization, the District Court cannot confer such jurisdiction either on the Bankruptcy Courts or any other Courts." *Id.*

In *In re Conley*, No. 382-990, slip op. at 14 (Bankr. M.D. Tenn. Jan. 26, 1983) (not reported), Judges Paine and Lundin held that, "the district court lacks any subject matter jurisdiction over bankruptcy matters." The court reasoned:

> Both the plurality and concurring opinions in *Northern Pipeline* refused to sever the jurisdictional grant in § 1471 between the bankruptcy courts, which the court found unconstitutional as presently constructed, and the district courts. Instead, both opinions unequivocally stated that § 241(a) was unconstitutional *in its entirety.* (*Id.*, emphasis in original)

See also Chamberlain Livestock Auction, Inc. v. *Aberdeen Production Credit Association*, 22 B.R. 750, 751 (Bankr. D.S.D. 1982) ("The intent of Congress, therefore, was to channel the bankruptcy proceedings to the bankruptcy courts. There appears no indication that Congress intended that the district courts have expanded jurisdiction to hear new kinds of proceedings"); *Color Craft Press, Ltd.* v. *Nationwide Shopper System, Inc. (In re Color Craft Press, Ltd.)*, No. 81M-3184, Adv. No. 82PM-97, slip op. at 8 (Bankr. D. Utah Feb. 7, 1983) (not reported) ("*Marathon* held that Section 241(a) was nonseverable and struck the entire statute, leaving no remnant of power in either bankruptcy or district courts.").

B. No Other Statute Confers Jurisdiction Over Bankruptcy Matters On The District Courts.

It is hornbook law that the "jurisdiction of the lower federal courts is . . . limited to those subjects encompassed within a statutory grant of jurisdiction." *Insurance Corp.* v. *Compagnie des Bauxites*, 102 S. Ct. 2099, 2104 (1982). There is no presumption in favor of federal jurisdiction. *Turner* v. *Bank of North America*, 4 U.S. (4 Dall.) 8, 11 (1799). Indeed, it is incumbent on each federal court to raise any question about subject matter jurisdiction "on its own motion." *Insurance Corp.* v. *Compagnie des Bauxites*, 102 S. Ct. at 2104; *California* v. *LaRue*, 409 U.S. 109, 112-13 n. 3 (1972).

The sole authorities for the local rule recited in the directive of the Judicial Council of the Seventh Circuit are 28 U.S.C. § 332(d) and 11 U.S.C. § 105. (App. 9) However the authority conferred by § 332(d) to "make all necessary and appropriate orders for the effective and expeditious administration of justice within its circuit," does not authorize the Council to confer jurisdiction on any court in the circuit. 11 U.S.C. § 105 provides, "The *bankruptcy court* may issue any order, process, or judgment that is necessary or proper to carry out the provisions of this title." (emphasis added). This provision merely confers authority on a properly constituted bankruptcy court to exercise powers attendant to its jurisdiction. The section is not an independent grant of bankruptcy jurisdiction. As stated in *Gillman* v. *Preston*, "11 U.S.C. § 105 does not confer subject matter jurisdiction. Instead, it is an investiture of broad powers to act after subject matter jurisdiction is established." No. 82C-736, Adv. No. 82PC-746, slip op. at 21-22 (Bankr. D. Utah Feb. 7, 1983) (not reported). Moreover, this provision expressly accords auxiliary powers to the *bankruptcy courts* and is no authority whatever for the *the district courts.*

We now consider whether the local rule can be justified by any other grant of jurisdiction over bankruptcy matters to the district courts. Diversity jurisdiction under 28 U.S.C.

§ 1332 cannot justify the adversary proceeding against petitioners.[10] Nor is there federal question jurisdiction under 28 U.S.C. § 1331 or jurisdiction under any other bankruptcy statute.

1. Federal question jurisdiction under 28 U.S.C. § 1331 does not extend to bankruptcy matters.

Subject matter jurisdiction of the federal courts exists only by express statutory grant. The grant in 28 U.S.C. § 1331 of jurisdiction over "all civil actions arising under the . . . laws . . . of the United States" does not, without more, confer jurisdiction over bankruptcy matters. The scope of this section is not defined by its bare words, but rather by whether Congress *intended* to include within those words jurisdiction over bankruptcy. *See Shoshone Mining Co.* v. *Rutter*, 177 U.S. 505, 506 (1900).[11]

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[10] With the exception of one subsidiary that is a California corporation, Debtors are Delaware corporations with their principal places of business in Illinois. Harvester and IH Steel are incorporated under Delaware and Illinois law respectively and both have their principal place of business in Illinois. All individual defendants are likewise residents of Illinois.

[11] The statutory question of whether bankruptcy jurisdiction is included within 28 U.S.C. § 1331 should not be confused with the constitutional issue addressed in *National Mutual Ins. Co.* v. *Tidewater Transfer Co.*, 337 U.S. 582 (1949). There the Court was divided as to whether the constitutional source was the bankruptcy clause of Article I, or the federal question clause of Article III. *See id.* at 594-99, 611-12, 652 n.3.

The question presented here is the *statutory* source of the district court's current jurisdiction over bankruptcy cases. As Justice Rutledge stated in *Tidewater*:

> [i]t has never heretofore been doubted that the constitutional grant of power is broader than the general federal question jurisdiction which Congress has from time to time thought to confer on district courts by statute. (*Id.* at 614)

Thus, even assuming that Article III's federal question clause is the constitutional source of the bankruptcy jurisdiction, it does not follow that bankruptcy matters are included

(footnote continued on next page)

The legislative history of bankruptcy jurisdiction and federal question jurisdiction demonstrates that Congress has never intended to include the former within the latter. The original statute conferring federal question jurisdiction was enacted in 1875. *See* 18 Stat. 470 (1875). Previously, Congress enacted statutory grants of jurisdiction over bankruptcy matters independent of any statute conferring federal question jurisdiction. *See* 5 Stat. 446 (1841) and 14 Stat. 517 (1867). Even after 1875, federal bankruptcy acts set forth grants of jurisdiction that were separate from and not dependent upon federal question jurisdiction. *See* 30 Stat. 545 (1898) and 92 Stat. 2668 (1978). Indeed the uniform practice of Congress has been to state the grant of jurisdiction over bankruptcy matters in a separate statutory enactment from its grant of federal question jurisdiction. The repeated practice of granting bankruptcy jurisdiction in separate jurisdictional statutes both before and after 1875 demonstrates that Congress has never intended that the grant of federal question jurisdiction under § 1331 include bankruptcy matters.

Romero v. *International Terminal Operating Co.*, 358 U.S. 354 (1959), is on point. In that case, the Court found no federal question jurisdiction under § 1331 over a claim arising under federal maritime law. The Court observed that the words "arising under the Constitution and laws of the United States" would appear to "fit [the plaintiff's claim] like a glove," but rejected "treating such statutes as a wooden set of self-sufficient words." *Id.* at 378-79. The Court held that the proper guide to interpreting § 1331 was the intent of Congress as revealed in the background of maritime jurisdiction compared to § 1331. The Court noted that Congress had consistently made separate provisions for conferring jurisdiction over maritime matters before the federal question statute was enacted in 1875 and had continued to utilize separate

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(footnote continued from preceding page)

within the *statutory* grant of federal question jurisdiction. That is a question of congressional intent. *See Shoshone*, 177 U.S. at 506.

jurisdictional statutes even after the federal question statute was enacted. Therefore, there was no basis to "suggest, even remotely" that Congress intended "the inclusion of maritime claims within the scope" of the statute creating federal question jurisdiction. 358 U.S. at 368.

In addition, there is "the well established maxim of statutory construction that a specific grant of power such as that contained in § 1471, prevails over the broader language of § 1331." *See In re Conley*, No. 382-990, slip op. at 21 (Bankr. M.D. Tenn. Jan. 26, 1983) (not reported). While in effect, the specific provisions for bankruptcy jurisdiction in 28 U.S.C. § 1471 (and its predecessors) were never intended to have § 1331 as a backup. Indeed, the elaborate bankruptcy court system established by both the 1898 and 1978 Acts shows that Congress has never intended that bankruptcy cases be brought directly in the district courts under § 1331. *Accord Gillman* v. *Preston Family Investment Co. (In re Richardson)*, No. 82C-736, Adv. No. 82PC-746, slip op. at 40 (Bankr. D. Utah Feb. 7, 1983) (not reported).

Nor can federal question jurisdiction over bankruptcy matters be implied from the mere fact that the Bankruptcy Reform Act of 1978 is a federal statute creating rights that are enforceable in the federal courts. An "independent jurisdictional basis" must exist. *See In General Atomic Co.* v. *United Nuclear Corp.*, 655 F.2d 968, 970 (9th Cir. 1981), *cert. denied*, 455 U.S. 948 (1982.)

In the aftermath of *Northern Pipeline* and absent an express authorization of jurisdiction, the district courts lack any such independent jurisdictional basis over bankruptcy matters.

2. The district courts have no bankruptcy jurisdiction under 28 U.S.C. § 1334.

As reenacted in 1948, this section provided: "The district courts shall have original jurisdiction, exclusive of the courts of the States, of all matters and proceedings in bankruptcy." This section has since become a legislative orphan. Although

clearly inconsistent with the jurisdictional provisions of the Bankruptcy Reform Act of 1978, it was never expressly repealed. It was amended to provide for bankruptcy appeals to the district courts, effective April 1, 1984. There is no legislative history that accounts for the delayed effect of the new §1334.[12] Most observers have concluded that the old §1334 was implicitly repealed by the 1978 Act, effective October 1, 1979.[13]

As noted in *In re Conley*, "the technical language of [the old] §1334 creates serious questions as to the scope of a district court's purported jurisdiction over bankruptcy adjudications." No. 382-990, slip op. at 17 (Bankr. M.D. Tenn. Jan. 26, 1983) (not reported). Whereas §1334 grants the district court original and exclusive jurisdiction of "all matters and proceedings" in bankruptcy, the invalidated 28 U.S.C. §1471 covered "all cases under Title 11," as well as "civil proceedings arising under Title 11 or arising in or related to cases under Title 11." Thus, the grant of jurisdiction in §1471 is considerably broader than that of §1334. As stated in *Conley*, "[s]urely Congress would have amended §1334 to include this broader language if §1334 was intended to have any continuing viability after passage of the Bankruptcy Reform Act." *Id.* at 18.

Moreover, §1334 has never been construed as applying to "plenary" adversary proceedings involving state law claims. *See Color Craft Press, Ltd.* v. *Nationwide Shopper Systems (In re Color Craft Press)*, No. 81M-3184, Adv. No. 82PM-974, slip op.

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[12] The new § 1334 provides for the district courts to exercise *appellate* jurisdiction over the bankruptcy courts. Although not formally effective until 1984, *(See* §402(b) of the 1978 Act) the new §1334 took operational effect on October 1, 1978 by virtue of the transitional provisions of the 1978 Act. *See* §405(c)(2) of the 1978 Act.

[13] *See* Vihon, *Delegation of Authority and the Model Rule: The Continuing Saga of Northern Pipeline*, 1983 COM. L.J. 64, 67-68; *In re Conley*, No. 382-00990, slip op. at 20 (Bankr. M.D. Tenn. Jan. 26, 1983) (not reported).

at 7 n.2 (Bankr. D. Utah Feb. 7, 1983) (not reported); *Still* v. *First Bank (In re Jorges Carpet Mills Inc.)*, No. 1-80-2516, Adv. No. 1-82-638, slip op. at 14 (Bankr. E.D. Tenn. Jan. 31, 1983) (not reported). Thus, whatever the continued effect of the old § 1334, it is not sufficient to bring this adversary proceeding before the district courts.

3. There is no jurisdictional remnant from the repealed 1898 Bankruptcy Act that confers jurisdiction.

Following *Northern Pipeline*, the Judicial Conference of the United States, through the Administrative Office of the United States Courts, promulgated to the courts of appeal and district courts, a model order which would refer all bankruptcy matters to bankruptcy judges in the event Congress failed to enact corrective legislation. The purported jurisdictional basis for this recommendation is stated in a memorandum by Carl Imlay, General Counsel of the Administrative Office of the United States Courts, dated July 22, 1982.[14] Mr. Imlay contends that, in spite of the express repeal of the Bankruptcy Act of 1898 by the Bankruptcy Reform Act of 1978, § 404(a) of the 1978 Act continues not only the existence of the bankruptcy courts but also the jurisdictional provisions of the 1898 Act. All that § 404(a) actually provides is that the existing bankruptcy courts shall exercise the jurisdiction conferred by § 1471 until the new bankruptcy courts come into existence on April 1, 1984.

Chairman Rodino of the House Judiciary Committee disagreed with Mr. Imlay, stating that "the shell of the former bankruptcy courts was explicitly continued" but that "the former jurisdiction of the courts was clearly not continued."[15]

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[14] Mr. Imlay's memorandum is set forth in full in H.R. Rep. No. 807, *supra* note 5, at 30-32 (1982).

[15] *See* H.R. Rep. No. 807, *supra* note 5, at 30. Absent any specific exception, Section 2(a) of the 1898 Act, which granted jurisdiction, was part of the blanket repeal in the Bankruptcy Reform Act of 1978. See § 401(a) of Pub. L. 95-598.

Chairman Rodino circulated Mr. Imlay's memorandum for comments to bankruptcy experts who had previously testified in the hearings. None of these bankruptcy experts agreed with Mr. Imlay.[16] *See* also *Color Craft Press, Ltd.* v. *Nationwide Shopper Systems, Inc. (In re Color Craft Press)*, No. 81M-3184 Adv. No. 82 PM-974, slip op. at 28-29 (Bankr. D. Utah Feb. 7, 1983) (not reported).

Nor does the Court's decision in *Northern Pipeline* revive bankruptcy jurisdiction under the 1898 Act. In *In re Conley*, No. 382-990 (Bankr. M.D. Tenn. Jan. 26, 1983) (not reported), the court rejected the contention that "the jurisdictional provision of the 1898 Bankruptcy Act was miraculously resurrected upon the abrogation of § 241(a)." Slip. op. at 8-9. The court observed that this Court's decision in *Northern Pipeline* "gave absolutely no indication" that the jurisdictional provisions of the 1898 Act were thereby revived. Moreover, the court noted that the opinion of the plurality in *Northern Pipeline* "casts grave doubts on the validity of the jurisdictional provision contained in the 1898 Act." *Id.* at 10.

4. Court rules cannot create bankruptcy jurisdiction

The Administrative Office of United States Courts has suggested that a final possible source of federal jurisdiction over bankruptcy matters is rules of court. (App. 13) The short response here is that court rules cannot grant subject matter jurisdiction. Rule 82 of the Federal Rules of Civil Procedure is typical. It states: "These rules shall not be construed to extend or limit the jurisdiction of the United States district courts. . . ." Bankruptcy Rule 928 has a similar recitation. Whether stated or not, this limitation exists as to any other rule of court, including any local rule of the district courts.

Rules 53 and 83, cited by the Administrative Office, do not create jurisdiction of bankruptcy matters. Rule 53 allows a

[16] H.R. Rep., No. 807, *supra* note 5, at 34-48 (1982).

district court to refer matters to a master to be paid by the parties:

> "Any such reference shall be the exception and not the rule. . . . [I]n actions to be tried without a jury, save in matters of account and of difficult computation of damages, a reference shall be made only upon a showing that some exceptional condition requires it."

References to masters thus are reserved for exceptional cases and are to be made on an individualized, case-by-case basis. The recital in the local rule that "exceptional circumstances exist," including the unconstitutionality of 28 U.S.C. § 1471 and the clear intent of Congress to refer bankruptcy matters to bankruptcy judges, is not a valid basis for blanket reference of all bankruptcy matters to bankruptcy judges. As this Court said in *LaBuy* v. *Howes Leather Co.*, 352 U.S. 249, 256 (1957), "[t]he use of masters is 'to aid judges in the performance of specific judicial duties, as they may arise in the progress of a cause'. . . . and not to displace the court."[17]

Rule 83 provides simply that the district courts can make rules which are "not inconsistent with these rules." This provision does not authorize the local rule here, which is categorically at variance with Rule 53.

Nor do Bankruptcy Rules 513 and 927, cited by the Administrative Office, create any jurisdiction. Rule 513 provides only that once a reference to a master has been made, the Federal Rules of Civil Procedure shall apply. Bankruptcy Rule 927 authorizes promulgation of "rules governing

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[17] Chief Circuit Judge Irving R. Kaufman has concluded from the *LaBuy* case that "with a few minor exceptions, references in nonjury cases run counter to the spirit and purpose of judicial administration in the federal courts." Kaufman, *Masters in the Federal Courts: Rule 53*, 58 COLUM. L. REV. 452, 459 (1958). Indeed, except for matters of account and damages, and the supervision of discovery, "it is difficult to conceive of a reference of a nonjury case that would meet the rigid standards of the *LaBuy* decision." 9 C. Wright and A. Miller, FEDERAL PRACTICE AND PROCEDURE 791 (1971).

practice and procedure under the Act not inconsistent with these rules." Yet the local rule here is inconsistent with Rule 53.

In sum, district court jurisdiction over bankruptcy matters cannot, since *Northern Pipeline*, be based on the jurisdiction granted in the Bankruptcy Reform Act of 1978. Nor does jurisdiction emanate from § 1331 or from either the old or the new § 1334. Finally, it cannot be predicated on a remnant of the 1898 Act or on any court rule.

III. The Local Rule Contravenes *Northern Pipeline* And Contradicts The Federal Rules And Principles Of Federal Jurisdiction

The Judicial Conference of the United States stated that its model rule is based on the premise that *Northern Pipeline* did not invalidate 28 U.S.C. § 1471(a) and (b) (App. 11). As discussed in the prior section, this premise is invalid and the local rule is accordingly void on this ground alone.

The current position of the Judicial Conference that bankruptcy matters can validly be referred to existing bankruptcy judges without any corrective action by Congress cannot be reconciled with this Court's decision in *Northern Pipeline*. This Court stayed its decision so that the Congress could restructure the bankruptcy courts because it could not presume that Congress would choose to have state law bankruptcy matters "routed to the United States district court." 102 S. Ct. at 2880 n.40. Such "routing" cannot be made proper now by directive from the Judicial Conference, the Judicial Council of the Seventh Circuit or the district courts, in the absence of legislative action by Congress.

In addition to being without basic authorization, the local rule substantially conflicts with even the most narrow construction of *Northern Pipeline*. At the very least, the plurality held that non-Article III judges may exercise very limited control over controversies involving private state law

claims. The plurality stated that two "principles" emerged from the relevant case law:

> First, it is clear that when Congress creates a substantive federal right, it possesses substantial discretion to prescribe the manner in which that right may be adjudicated—including the assignment to an adjunct of some functions historically performed by judges . . . . Second, the functions of the adjunct must be limited in such a way that the "essential attributes" of judicial power are retained in the Art. III court. (*Id.* at 2876)

It singled out for criticism several specific provisions of § 1471 as contravening those principles. *Id.* at 2878-79. Notwithstanding *Northern Pipeline*, the local rule reenacts a number of § 1471's provisions and thus offends the very principles described in *Northern Pipeline*.

The plurality drew a distinction between assigning cases to adjunct courts arising out of "congressionally created statutory rights" and those arising out of "rights not created by Congress." It stated:

> while *Crowell* certainly endorsed the proposition that Congress possesses broad discretion to assign factfinding functions to an adjunct created to aid in the adjudication of congressionally created statutory rights, *Crowell* does not support the further proposition necessary to appellants' argument—that Congress possesses the same degree of discretion in assigning traditionally judicial power to adjuncts engaged in the adjudication of rights *not* created by Congress. (*Id.* at 2877; emphasis in original).

Notwithstanding this admonition, the local rule delegates to the bankruptcy judges jurisdiction over private state law claims. See ¶ C(1) of local rule (App. 4). A more direct conflict with *Northern Pipeline* is difficult to imagine.

In addition, the local rule perpetuates a number of the features of the invalidated § 1471 that the plurality found were an impermissible vesting of "all 'essential attributes' of the judicial power of the United States in the 'adjunct'

bankruptcy court." *Id.* at 2878. Just like the invalidated § 1471, the local rule permits the bankruptcy court judges to exercise bankruptcy jurisdiction extending beyond "channeled factfinding functions." *Id.* at 2878-79. Thus, the local rule permits bankruptcy judges to "perform . . . all acts and duties necessary for the handling" of bankruptcy cases, with four enumerated exceptions. See ¶ D(1) (App. 5).

Also, the plurality objected to § 1471's permitting "the bankruptcy courts [to] issue final judgments, which are binding and enforceable even in the absence of an appeal." *Id.* at 2879. Yet, the local rule permits the bankruptcy judge to enter orders and judgments that "are effective upon entry by the Clerk," in a broad variety of cases, including this one. See ¶ D(2) and (3) (App. 5-6).[18] This feature of the local rule also flatly contravenes *Northern Pipeline.*

The local rule also conflicts with the existing Rules of Civil Procedure. It requires the district court to review all orders proposed by bankruptcy judges but provides that the court "need give no deference to the findings of the bankruptcy judge." See ¶ E(2)(a) and (b) (App. 6-7). Rule 53, F.R.C.P., made applicable by Bankruptcy Rule 513, on the other hand, requires that "the court shall accept the master's findings of fact unless clearly erroneous."[19]

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[18] The scheme behind the local rule is based upon a distinction between "related proceedings" and all other bankruptcy proceedings. The bankruptcy judges' orders are effective upon entry as to the latter category, but not with respect to "related proceedings." "Related proceedings" exclude a large number of cases arising out of state law claims. *See* ¶ D(3)(a) (App. 5-6). In fact, the rule explicitly states, "[a] proceeding is not a related proceeding merely because the outcome will be affected by state law." *Id.* In apparent disregard of *Northern Pipeline*, the rule appears to categorize the adversary proceeding against petitioners as *not* a "related proceeding."

[19] The local rule excludes the statement in the Judicial Conference's model rule that referral of matters to bankruptcy judges is warranted by "the specialized expertise necessary to the determination of bankruptcy matters." (App. 13 & 19).

The local rule also conflicts with the longstanding principle that federal jurisdiction cannot arise from the consent of the parties. The local rule allows a bankruptcy judge to enter a "judgment or dispositive order" even in "related proceedings" if "the parties to the proceeding consent to entry of the judgment or order." See ¶ D(3)(b) (App. 6). This provision cannot be squared with the long line of cases holding that consent of the parties does not create jurisdiction and that the courts accordingly must raise questions about subject matter jurisdiction on their own motion. *Clark* v. *Paul Gray, Inc.*, 306 U.S. 583, 588 (1939); *St. Paul Mercury Indemnity Co.* v. *Red Cab Co.*, 303 U.S. 283, 297 (1939); *Louisville & Nashville R. Co.* v. *Mottley*, 211 U.S. 149, 153 (1908).

Finally, even the Justice Department refrains from backing the validity of the local rules referring bankruptcy matters to bankruptcy judges. Jonathan Rose, Assistant Attorney General in charge of the Office of Policy, testified about the proposed model rule on November 10, 1982 before a Senate subcommittee. Congressman Butler advised the House on December 3, 1982 that Mr. Rose was "frankly uncertain whether the proposed rule would withstand a judicial challenge." Mr. Rose explained that it was "unclear" whether *Northern Pipeline* "may be limited" by reading it as leaving "untouched" the grants of district court jurisdiction in § 1471(a) and (b). He concluded that the "permissible scope of district court jurisdiction over bankruptcy matters would, of course, be subject to substantial litigation before it would be firmly settled." 128 Cong. Rec. H 8875, Dec. 3, 1982.

Even if some residual jurisdiction over bankruptcy matters exists, the local rule cannot stand because it contravenes *Northern Pipeline* as well as other rules and principles of federal jurisdiction.

CONCLUSION

For all the foregoing reasons, the Court should enter writs of prohibition and mandamus prohibiting the United States District Court and the Bankruptcy Court for the Northern District of Illinois from exercising any jurisdiction in the adversary proceeding against petitioners and commanding said courts to refrain from enforcing the local rule in that proceeding.

Respectfully submitted,

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February 16, 1983

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United States District Court

NORTHERN DISTRICT OF ILLINOIS

GENERAL ORDER

By direction of the full Court met in Executive Session on Thursday, 16 December, 1982, the following is adopted as a Rule of this Court:

A. RESOLUTION

The purpose of this rule is to supplement existing law and rules in respect to the authority of the bankruptcy judges of this district to act in bankruptcy cases and proceedings until Congress enacts appropriate remedial legislation in response to the Supreme Court's decision in *Northern Pipeline Construction Co.* v. *Marathone Pipe Line Co.*, U.S. , 102 S. Ct. 2858 (1982), or until March 31, 1984, whichever first occurs.

The judges of the district court find that exceptional circumstances exist. These circumstances include: (1) the unconstitutionality of the grant of power to bankruptcy judges in section 241(a) of Public law 95-598; (2) the clear intent of Congress to refer bankruptcy matters to bankruptcy judges.

Therefore, the orderly conduct of the business of the court requires this referral of bankruptcy cases to the bankruptcy judges.

B. FILING OF BANKRUPTCY PAPERS

The Court of Bankruptcy constituted by § 404 of Public Law 95-598 shall continue to be known as the United States Bankruptcy Court of this district. The Clerk of the Bankruptcy Court is hereby designated to maintain all files in bankruptcy cases and adversary proceedings. All papers in cases or proceedings arising under or related to Title 11 shall be filed with the Clerk of the Bankruptcy Court regardless of whether the case or proceeding is before a bankruptcy judge or a judge of the district court, except that a judgment by the district judge shall be filed in accordance with Rule 921 of the Bankruptcy Rules.

C. REFERENCE TO BANKRUPTCY JUDGES

(1) All cases under Title 11 and all civil proceedings arising under Title 11 or arising in or related to cases under Title 11 are referred to the bankruptcy judges of this district.

(2) The reference to a bankruptcy judge may be withdrawn by the district court at any time on its own motion or on timely motion by a party. A motion for withdrawal of reference shall not stay any bankruptcy matter pending before a bankruptcy judge unless a specific stay is issued by the district court. If a reference is withdrawn, the district court may retain the entire matter, may refer part of the matter back to the bankruptcy judge, or may refer the entire matter back to the bankruptcy judge with instructions specifying the powers and functions that the bankruptcy judge may exercise. Any matter in which the reference is withdrawn shall be reassigned to a district judge in accordance with the court's usual system for assigning civil cases.

(3) Referred cases and proceedings may be transferred in whole or in part between bankruptcy judges within the district without approval of a district judge.

D. POWERS OF BANKRUPTCY JUDGES

(1) The bankruptcy judges may perform in referred bankruptcy cases and proceedings all acts and duties necessary for the handling of those cases and proceedings except that the bankruptcy judges may not conduct:

(a) a proceeding to enjoin a court;

(b) a proceeding to punish a criminal contempt—

(i) not committed in the bankruptcy judge's actual presence; or

(ii) warranting a punishment of imprisonment;

(c) an appeal from a judgment, order, decree, or decision of a United States bankruptcy judge; or

(d) jury trials.

Those matters which may not be performed by a bankruptcy judge shall be transferred to a district judge.

(2) Except as provided in (D) (3), orders and judgments of bankruptcy judges shall be effective upon entry by the Clerk of the Bankruptcy Court, unless stayed by the bankruptcy judge or a district judge.

(3) (a) Related proceedings are those civil proceedings that, in the absence of a petition in bankruptcy, could have been brought in a district court or a state court. Related proceedings include, but are not limited to, claims brought by the estate against parties who have not filed claims against the estate. Related proceedings do not include: contested and uncontested matters concerning the administration of the estate; allowance of and objection to claims against the estate; counterclaims by the estate in whatever amount against persons filing claims against the estate; orders in respect to obtaining credit; orders to turn over property of the estate; proceedings to set aside preferences and fraudulent conveyances; proceedings in respect to lifting of the automatic stay; proceedings to determine dischargeability of

particular debts; proceedings to object to the discharge; proceedings in respect to the confirmation of plans; orders approving the sale of property where not arising from proceedings resulting from claims brought by the estate against parties who have not filed claims against the estate; and similar matters. A proceeding is not a related proceeding merely because the outcome will be affected by state law.

(b) In related proceedings the bankruptcy judge may not enter a judgment or dispositive order, but shall submit findings, conclusions, and a proposed judgment or order to the district judge, unless the parties to the proceeding consent to entry of the judgment or order by the bankruptcy judge.

E. DISTRICT COURT REVIEW

(1) A notice of appeal from a final order or judgment or proposed order or judgment of a bankruptcy judge or an application for leave to appeal an interlocutory order of a bankruptcy judge, shall be filed within 10 days of the date of entry of the judgment or order or of the lodgment of the proposed judgment or order. As modified by sections (E) (2) (a) and (b) of this rule, the procedures set forth in Part VIII of the Bankruptcy Rules apply to appeals of bankruptcy judges' judgments and orders and the procedures set forth in Bankruptcy Interim Rule 8004 apply to applications for leave to appeal interlocutory orders of bankruptcy judges. Modification by the district judge or the bankruptcy judge of time for appeal is governed by Rule 802 of the Bankruptcy Rules.

(2) (a) A district judge shall review:

(i) an order or judgment entered under paragraph (D) (2) if a timely notice of appeal has been filed or if a timely application for leave to appeal has been granted;

(ii) an order or judgment entered under paragraph (D) (2) if the bankruptcy judge certifies that circumstances require that the order or judgment be approved by a district judge, whether or not the matter was controverted before the bankruptcy judge or any notice of appeal or application for leave to appeal was filed; and

(iii) a proposed order or judgment lodged under paragraph (D) (3), whether or not any notice of appeal or application for leave to appeal has been filed.

(b) In conducting review, the district judge may hold a hearing and may receive such evidence as appropriate and may accept, reject, or modify, in whole or in part, the order or judgment of the bankruptcy judge, and need give no deference to the findings of the bankruptcy judge. At the conclusion of the review, the district judge shall enter an appropriate order or judgment.

(3) When the bankruptcy judge certifies that circumstances require immediate review by a district judge of any matter subject to review under paragraph (E) (2), the district judge shall review the matter and enter an order or judgment as soon as possible.

(4) It shall be the burden of the parties to raise the issue of whether any proceeding is a related proceeding prior to the time of the entry of the order or judgment of the district judge after review.

F. LOCAL RULES

In proceedings before a bankruptcy judge, the local rules of the bankruptcy court shall apply. In proceedings before a judge of the district court, the local rules of the district court shall apply.

G. BANKRUPTCY RULES AND TITLE IV OF PUBLIC LAW 95-598

Courts of bankruptcy and procedure in bankruptcy shall continue to be governed by Title IV of Public Law

95-598 as amended and by the bankruptcy rules prescribed by the Supreme Court of the United States pursuant to 28 U.S.C. § 2075 and limited by SEC. 405(d) of the Act, to the extent that such Title and Rules are not inconsistent with the holding of Northern Pipeline Construction Co. v. Marathon Pipe Line Co., U.S. , 102 S. Ct. 2858 (1982).

H. EFFECTIVE DATE AND PENDING CASES

This rule shall become effective December 25, 1982, and shall apply to all bankruptcy cases and proceedings not governed by the Bankruptcy Act of 1898 as amended, and filed on or after October 1, 1979. Any bankruptcy matters pending before a bankruptcy judge on December 25, 1982 shall be deemed referred to that judge.

ENTER:

FOR THE COURT

/s/ FRANK J. McGARR
Chief Judge

Dated at Chicago, Illinois, this 20th day of December 1982.

Judicial Council of the Seventh Circuit

219 South Dearborn Street
Chicago, Illinois 60604

December 23, 1982

HON. WALTER J. CUMMINGS, Chief Judge
HON. WILBUR F. PELL, JR., Circuit Judge
HON. WILLIAM J. BAUER, Circuit Judge
HON. HARLINGTON WOOD, JR., Circuit Judge
HON. RICHARD D. CUDAHY, Circuit Judge
HON. JESSE E. ESCHBACH, Circuit Judge
HON. RICHARD A. POSNER, Circuit Judge
HON. JOHN L. COFFEY, Circuit Judge
HON. CALE J. HOLDER, District Judge
HON. JOHN W. REYNOLDS, Chief District Judge
HON. JAMES L. FOREMAN, Chief District Judge
HON. BARBARA B. CRABB, Chief District Judge

ORDER

Acting pursuant to the authority vested in the Judicial Council by 28 U.S.C. § 332(d), the Judicial Council of the Seventh Circuit concludes that the uniform effective and expeditious administration of justice within this circuit requires that a rule substantially similar to the attached be adopted by the district courts of this circuit pursuant to 11 U.S.C. § 105 for the administration of the bankruptcy system.

It is so ordered.

Administrative Office of the United States Courts

WASHINGTON, D.C. 20544

September 27, 1982

MEMORANDUM TO ALL:

JUDGES, UNITED STATES COURTS OF APPEAL
JUDGES, UNITED STATES DISTRICT COURTS
JUDGES, UNITED STATES BANKRUPTCY COURTS
CLERKS, UNITED STATES BANKRUPTCY COURTS

SUBJECT:

The Bankruptcy Court System after October 4, 1982 in Absence of Congressional Action.

The Supreme Court's recent decision in *Northern Pipeline Construction Co.* v. *Marathon Pipe Line Co., et al,* 102 S. Ct. 2858 (1982) held that the broad grant of jurisdiction to bankruptcy judges under the 1978 Act violates Article III of the Constitution. In applying its decision prospectively, the Court stayed its judgment until October 4, 1982 in order to afford the Congress an opportunity to reconstitute the bankruptcy courts or adopt some other valid means of adjudication, without impairing the interim administration of the bankruptcy laws.

During July and August, both the House and Senate held hearings on this important issue. Earlier this month, the Executive Committee of the Judicial Conference provided the Congress with its views and offered draft legislation for revision of the current law in order to satisfy the Supreme Court's decision, with minimum of disruption to the bankruptcy court structure. While it is hoped that the Congress will take affirmative action to remedy the constitutional

defects in the bankruptcy law before the stay terminates on October 4, it is possible it may not have time to do so.

Therefore, the following is the view of the Administrative Office of the United States Courts of the status of the bankruptcy law during the transition period ending March 31, 1984 if the Congress fails to act by October 4 and no extension of the stay is granted.

In *Marathon*, the Court found that certain powers assigned to bankruptcy judges by the 1978 Bankruptcy Act could be constitutionally exercised only by an Article III judge. The Court refused to sever the unconstitutional excess and thus struck the Act's assignment of powers to bankruptcy judges in its entirety, effective October 5, 1982.

Marathon does not cause a jurisdictional lapse. The Administrative Office concludes that *Marathon* did not invalidate 11 [sic] U.S.C. sections 1471 (a), (b). In addition, sections 404 and 405 of the 1978 Act also vest bankruptcy powers in the district courts as "courts of bankruptcy" until 1984.

The attached rule is an interim measure by which district courts may delegate many of their bankruptcy powers to bankruptcy judges. The authority for this is found in section 105 of the 1978 Act (11 U.S.C. sec. 105), which gives courts of bankruptcy the power to "issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title," and in Bankruptcy Rule 927, which gives bankruptcy courts the power to adopt "rules governing practice and procedure under the Act." This delegation of power is consistent with the long tradition of a bankruptcy court consisting of two judicial officers and the clear intent of the Congress to continue a two-officer court of bankruptcy through 1984.

Under the Rule, all bankruptcy matters are initially referred to a bankruptcy judge. [Section b(1) of the Rule.] In proceedings not involving a final judgment in a *Marathon* claim, the bankruptcy judge may enter orders and judgments that become effective immediately, subject to district court

review if requested by a party. [Section (c)(2).] With respect to final judgments in *Marathon* claims, the bankruptcy judge prepares recommended findings and conclusions and a proposed judgment. [Section (c)(3).] A district judge then reviews the recommendation and enters a judgment. [Section (c)(5).] Where the bankruptcy judge certifies that circumstances require, an order or judgment entered by a bankruptcy judge will be confirmed by a district judge even if no objection is filed.

The district court will provide expedited review or confirmation of any order, judgment, or proposed judgment where the bankruptcy judge certifies prompt review is necessary.

/s/ WILLIAM E. FOLEY
William E. Foley

Attachment

RULE

(a) Emergency Resolution

The purpose of this rule is to convey to the bankruptcy judges of this district authority to act in bankruptcy cases and proceedings until the Congress enacts appropriate remedial legislation in response to the Supreme Court's decision in *Northern Pipeline Construction Co.* v. *Marathon Pipe Line, Co.*, U.S. , 102 S. Ct. 2858 (1982), or until March 31, 1984, whichever first occurs.

The judges of the district court find that exceptional circumstances exist. These circumstances include: (1) the unanticipated unconstitutionality of the grant of power to bankruptcy judges in section 241(a) of the Bankruptcy Reform Act of 1978; (2) the clear intent of the Congress to refer bankruptcy matters to bankruptcy judges; (3) the specialized expertise necessary to the determination of bankruptcy matters; and (4) the administrative difficulty of the district courts' assuming the existing bankruptcy caseload on short notice.

Therefore, pursuant to 11 U.S.C. sec. 105, sections 404 and 405 of the Bankruptcy Act of 1978, Rules 53 and 83 of the Federal Rules of Civil Procedure, and Rules 513 and 927 of the Bankruptcy Rules, the orderly conduct of the business of the court requires this referral of bankruptcy cases to the bankruptcy judges.

(b) Reference to Bankruptcy Judges

(1) All cases under Title 11 and all civil proceedings arising in or related to cases under Title 11 are referred to the bankruptcy judges of this district.

(2) The reference to a bankruptcy judge may be withdrawn by the district court on its own motion or on timely motion by a party. A motion for withdrawal of reference shall not stay any bankruptcy matter pending before a bankruptcy judge unless a specific stay is issued by the district court. If a reference is withdrawn, the district court may

retain the entire matter, may refer part of the matter back to the bankruptcy judge, or may refer the entire matter back to the bankruptcy judge with instructions specifying the powers and functions that the bankruptcy judge may exercise. Any matter in which the reference is withdrawn shall be reassigned to a district judge in accordance with the court's usual system for assigning civil cases.

(c) Powers of Bankruptcy Judges and District Court Review

(1) The bankruptcy judges may perform in referred bankruptcy matters all acts and duties necessary for the handling of those matters and may conduct all proceedings except:

(A) a proceeding to enjoin a court;

(B) a proceeding to punish a criminal contempt;

(C) an appeal from a judgment, order, decree, or decision of a United States bankruptcy judge; or

(D) jury trials.

(2) Except as provided in (3), the orders and judgments of bankruptcy judges shall be effective upon entry by the clerk, unless stayed by the bankruptcy judge or the district court.

(3) In civil proceedings related to cases under Title 11 but not arising in or under Title 11, or wherever otherwise constitutionally required, judgments as defined in Rule 54(a) of the Federal Rules of Civil Procedure that would be appealable if rendered by a district judge and that do not result from a stipulation among the parties, shall not be effective and shall not be entered until the judgment has been signed by a district judge. In such proceedings, the bankruptcy judge shall submit findings, conclusions, and a proposed judgment to the district judge.

(4) Objections to an order or judgment entered under paragraph (2), or a proposed judgment lodged under paragraph (3) must be filed within 10 days after entry or lodgment thereof by the clerk. The time for filing objections

may, for cause, be shortened by the bankruptcy judge or the district court.

(5) (A) A district judge shall review:

(i) an order or judgment entered under paragraph (2) if a timely objection has been filed;

(ii) an order or judgment entered under paragraph (2) if the bankruptcy judge certifies that circumstances require that the order or judgment be approved by a district judge, whether or not the matter was controverted before the bankruptcy judge or any objection was filed; and

(iii) a proposed judgment lodged under paragraph (3), whether or not any objection has been filed.

(B) In conducting review, the district judge may hold a hearing and may receive such evidence as he deems appropriate and may accept, reject, or modify, in whole or in part, the order or judgment of the bankruptcy judge, and need give no deference to the findings of the bankruptcy judge. At the conclusion of the review, the district judge shall enter an appropriate order or judgment.

(6) When the bankruptcy judge certifies that circumstances require immediate review by a district judge of any matter subject to review under paragraph (5), the district judge shall review the matter and enter an order or judgment as soon as possible.

(d) Effective Date and Pending Cases

This rule shall become effective October 5, 1982, and shall apply to all cases not governed by the Bankruptcy Act of 1898, as amended. Any bankruptcy matters pending on October 5, 1982 before a bankruptcy judge shall be deemed referred to that judge.

Administrative Office of the United States Courts

WASHINGTON, D.C. 20544

December 3, 1982

MEMORANDUM TO ALL:

JUDGES, U.S. COURTS of APPEALS
JUDGES, U.S. DISTRICT COURTS
JUDGES, U.S. BANKRUPTCY COURTS
CLERKS, U.S. DISTRICT COURTS
CLERKS, U.S. BANKRUPTCY COURTS

SUBJECT:

Continued Operation of the Bankruptcy Court System after December 24, 1982, in the Absence of Congressional Action.

On September 27, 1982, I transmitted by memorandum a model rule and sample order in accordance with the following September 23, 1982 Resolution of the Judicial Conference:

> RESOLVED:
>
> That the Conference request the Director to provide each circuit with a proposed rule to take effect October 5, 1982 in the absence of congressional action or extension of the stay, which rule will permit the bankruptcy system to continue without disruption in reliance upon jurisdictional grants remaining in the law as limited by *Northern Pipeline Construction Co.* v. *Marathon Pipe Line Co., et al.*

My September 27, 1982, transmission was, of course, designed to provide a "contingency approach," as specified in the Conference's Resolution, "in the absence of Congressional action or extension of the stay," *then* scheduled to expire on

October 4. As you know, the Supreme Court, on October 4 extended the stay until December 24, because Congress was not able to act before recessing on October 2.

Congress reconvened on November 29, five days ago. While efforts to take action are now being made by the Congress, I believe prudence requires that I again provide "a proposed rule . . . which . . . will permit the bankruptcy system to continue without disruption" should Congress be unable to act—or if the stay is not again extended—by December 24.

In *Northern Pipeline Construction Co.* v. *Marathon Pipe Line Co., et al.*, 102 S.Ct. 2858 (1982) the Supreme Court found that certain powers assigned to bankruptcy judges by the 1978 Bankruptcy Reform Act could be exercised constitutionally only by Article III judges, that language in the Act conferring unconstitutional authority could not be severed from language conferring other powers, and therefore provided the opportunity for Congress to correct the jurisdictional problem.

The Conference on September 10, 1982, advised Congress of its belief that the Supreme Court decision did not completely invalidate subsections (a) and (b) of section 1471 of Title 28, United States Code, as enacted in section 241(a) of the 1978 Act. In addition, sections 404 and 405 of that Act expressly vest bankruptcy powers in the *district* courts as "courts of bankruptcy" *until April 1, 1984.* The attached model rule has been formulated in reliance upon the remaining valid elements in the 1978 Act.

The attached model rule is intended to be an interim measure, by which district courts may delegate many of their bankruptcy powers to bankruptcy judges. The authority for that delegation is found in section 105 of the 1978 Act, which gives courts of bankruptcy the power to "issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title," and in Bankruptcy

Rule 927, which gives bankruptcy courts the power to adopt "rules governing practice and procedure under the Act."

Under the model rule, all bankruptcy matters are initially referred to a bankruptcy judge. [Section b(1) of the Rule.] In proceedings not involving a final judgment on a *Marathon* claim, the bankruptcy judge may enter orders and judgments that become effective immediately, subject to district court review if requested by a party [Section (c)(2).] With respect to final judgments in *Marathon* claims the bankruptcy judge prepares recommended findings and conclusions and a proposed judgment. [Section (c)(3).] A district judge then reviews the recommendation and enters a judgment. [Section (c)(5).] Where the bankruptcy judge certifies that circumstances require, an order or judgment entered by a bankruptcy judge will be confirmed by a district judge even if no objection is filed.

The district court will provide expedited review or confirmation of any order, judgment, or proposed judgment where the bankruptcy judge certifies prompt review is necessary.

/s/ WILLIAM E. FOLEY
William E. Foley

Attachments: Model Rule
Sample Order

(a) Emergency Resolution

The purpose of this rule is to supplement existing law and rules in respect to the authority of the bankruptcy judges of this district to act in bankruptcy cases and proceedings until Congress enacts appropriate remedial legislation in response to the Supreme Court's decision in *Northern Pipeline Construction Co.* v. *Marathon Pipe Line Co.*, U.S. , 102 S. Ct. 2858 (1982), or until March 31, 1984, whichever first occurs.

The judges of the district court find that exceptional circumstances exist. These circumstances include: (1) the unanticipated unconstitutionality of the grant of power to bankruptcy judges in section 241(a) of Public Law 95-598; (2) the clear intent of Congress to refer bankruptcy matters to bankruptcy judges; (3) the specialized expertise necessary to the determination of bankruptcy matters; and (4) the administrative difficulty of the district courts assuming the existing bankruptcy caseload on short notice.

Therefore, the orderly conduct of the business of the court requires this referral of bankruptcy cases to the bankruptcy judges.

(b) Filing of Bankruptcy Papers

The court of bankruptcy constituted by § 404 of Public Law 95-598 shall continue to be known as the United States Bankruptcy Court of this district. The Clerk of the Bankruptcy Court is hereby designated to maintain all files in bankruptcy cases and adversary proceedings. All papers in cases or proceedings arising under or related to Title 11 shall be filed with the Clerk of the Bankruptcy Court regardless of whether the case or proceeding is before a bankruptcy judge or a judge of the district court, except that judgment by the district judge shall be filed in accordance with Rule 921 of the Bankruptcy Rules.

(c) Reference to Bankruptcy Judges

(1) All cases under Title 11 and all civil proceedings arising under Title 11 or arising in or related to cases under Title 11 are referred to the bankruptcy judges of this district.

(2) The reference to a bankruptcy judge may be withdrawn by the district court at any time on its own motion or on timely motion by a party. A motion for withdrawal of reference shall not stay any bankruptcy matter pending before a bankruptcy judge unless a specific stay is issued by the district court. If a reference is withdrawn, the district court may retain the entire matter, may refer part of the matter back to the bankruptcy judge, or may refer the entire matter back to the bankruptcy judge with instructions specifying the powers and functions that the bankruptcy judge may exercise. Any matter in which the reference is withdrawn shall be reassigned to a district judge in accordance with the court's usual system for assigning civil cases.

(3) Referred cases and proceedings may be transferred in whole or in part between bankruptcy judges within the district without approval of a district judge.

(d) Powers of Bankruptcy Judges

(1) The bankruptcy judges may perform in referred bankruptcy cases and proceedings all acts and duties necessary for the handling of those cases and proceedings except that the bankruptcy judges may not conduct:

(A) a proceeding to enjoin a court;

(B) a proceeding to punish a criminal contempt—

(i) not committed in the bankruptcy judge's actual presence; or

(ii) warranting a punishment of imprisonment;

(C) an appeal from a judgment, order, decree, or decision of a United States Bankruptcy judge; or

(D) jury trials.

Those matters which may not be performed by a bankruptcy judge shall be transferred to a district judge.

(2) Except as provided in (d)(3), orders and judgments of bankruptcy judges shall be effective upon entry by the Clerk of the Bankruptcy Court, unless stayed by the bankruptcy judge or a district judge.

(3) (A) Related proceedings are those civil proceedings that, in the absence of a petition in bankruptcy, could have been brought in a district court or a state court. Related proceedings include, but are not limited to, claims brought by the estate against parties who have not filed claims against the estate. Related proceedings do not include: contested and uncontested matters concerning the administration of the estate; allowance of and objection to claims against the estate; counterclaims by the estate in whatever amount against persons filing claims against the estate; orders in respect to obtaining credit; orders to turn over property of the estate; proceedings to set aside preferences and fraudulent conveyances; proceedings in respect to lifting of the automatic stay; proceedings to determine dischargeability of particular debts; proceedings to object to the discharge; proceedings in respect to the confirmation of plans; orders approving the sale of property where not arising from proceedings resulting from claims brought by the estate against parties who have not filed claims against the estate; and similar matters. A proceeding is not a related proceeding merely because the outcome will be affected by state law.

(B) In related proceedings the bankruptcy judge may not enter a judgment or dispositive order, but shall submit findings, conclusions, and a proposed judgment or order to the district judge, unless the parties to the proceeding consent to entry of the judgment or order by the bankruptcy judge.

(e) District Court Review

(1) A notice of appeal from a final order or judgment or proposed order or judgment of a bankruptcy judge or an application for leave to appeal an interlocutory order of a

bankruptcy judge, shall be filed within 10 days of the date of entry of the judgment or order or of the lodgement of the proposed judgment or order. As modified by sections (c)2A and B of this rule, the procedures set forth in Part VIII of the Bankruptcy Rules apply to appeals of bankruptcy judges' judgments and orders and the procedures set forth in Bankruptcy Interim Rule 8004 apply to applications for leave to appeal interlocutory orders of bankruptcy judges. Modification by the district judge or the bankruptcy judge of time for appeal is governed by Rule 802 of the Bankruptcy Rules.

(2) (A) A district judge shall review:

(i) an order or judgment entered under paragraph (d)(2) if a timely notice of appeal has been filed or if a timely application for leave to appeal has been granted;

(ii) an order or judgment entered under paragraph (d)(2) if the bankruptcy judge certifies that circumstances require that the order or judgment be approved by a district judge, whether or not the matter was controverted before the bankruptcy judge or any notice of appeal or application for leave to appeal was filed; and

(iii) a proposed order or judgment lodged under paragraph (d)(3), whether or not any notice of appeal or application for leave to appeal has been filed.

(B) In conducting review, the district judge may hold a hearing and may receive such evidence as appropriate and may accept, reject, or modify, in whole or in part, the order or judgment of the bankruptcy judge, and need give no deference to the findings of the bankruptcy judge. At the conclusion of the review, the district judge shall enter an appropriate order or judgment.

(3) When the bankruptcy judge certifies that circumstances require immediate review by a district judge of any matter subject to review under paragraph (d)(2), the district

judge shall review the matter and enter an order or judgment as soon as possible.

(4) It shall be the burden of the parties to raise the issue of whether any proceeding is a related proceeding prior to the time of the entry of the order of judgment of the district judge after review.

(f) Local Rules

In proceedings before a bankruptcy judge, the local rules of the bankruptcy court shall apply. In proceedings before a judge of the district court, the local rules of the district court shall apply.

(g) Bankruptcy Rules and Title IV of Public Law 95-598

Courts of bankruptcy and procedure in bankruptcy shall continue to be governed by Title IV of Public Law 95-598 as amended and by the bankruptcy rules prescribed by the Supreme Court of the United States pursuant to 28 U.S.C. § 2075 and limited by Sec. 405(d) of the Act, to the extent that such Title and Rules are not inconsistent with the holding of *Northern Pipeline Construction Co.* v. *Marathon Pipe Line Co.*, U.S. , 102 S.Ct.2858 (1982).

(h) Effective Date and Pending Cases

This rule shall become effective December 25, 1982, and shall apply to all bankruptcy cases and proceedings not governed by the Bankruptcy Act of 1898 as amended, and filed on or after October 1, 1979. Any bankruptcy matters pending before a bankruptcy judge on December 25, 1982, shall be deemed referred to that judge.

United States District Bankruptcy Court

FOR THE NORTHERN DISTRICT OF ILLINOIS

EASTERN DIVISION

In re **WISCONSIN STEEL COMPANY, a Delaware corporation, et. al.,** *Debtors.*	Chapter 11 Nos. 80 B 03766 through 80 B 03773
WSC CORP. AND ALL OF THE OTHER DEBTORS IN POSSESSION, *Plaintiffs,* vs. **INTERNATIONAL HARVESTER COMPANY, and IH STEEL, ROGER E. ANDERSON, KARL D. BAYS, ANDREW F. BRIMMER, WILLIAM E. CALLAHAN, MARY GARST, JAMES J. DOYLE, ARTHUR G. HANSEN, GEORGE E. KECK, JOSEPH B. LANTERMAN, BROOKS McCORMICK, LOUIS W. MENK, GRAHAM J. MORGAN, KEITH R. POTTER, JOHN T. RETTALIATA, HAROLD BYRON SMITH, EDSON W. SPENCER, T. M. THOMPSON and OMER G. VOSS,** *Defendants.*	Adversary No. 81 A 0442

ORDER

Introduction

The present litigation before the Court began when International Harvester Company filed a claim in these cases

for more than $146 million. The debtors in possession filed objections to that claim and also filed a counterclaim against International Harvester Company and its affiliate, IH Steel. (The debtors in possession, as counterclaimants, shall hereinafter collectively be referred to as "WSC". International Harvester Company and IH Steel shall hereinafter collectively be referred to as "Harvester".) On March 30, 1982, WSC amended its counterclaim (the Counterclaim) and added as additional defendants certain of Harvester's officers and directors.

Earlier in this proceeding Harvester filed a motion for summary judgment. Because of the existence of numerous disputed issues of material fact, that motion was denied. Harvester and the individual defendants have now moved to dismiss the Counterclaim pursuant to Rule 712 of the Rules of Bankruptcy Procedure for failure to state a claim upon which relief can be granted. It is this motion to dismiss that is presented before the Court for decision.

Harvester and the individual defendants do not dispute that, for the purpose of deciding the motion to dismiss, the allegations of the Counterclaim must be liberally construed in favor of WSC and are deemed admitted by defendants. Further, the Counterclaim is not subject to dismissal unless it appears to the court beyond doubt that WSC can prove no facts in support of its claim to entitle it to relief. *Jenkins* v. *McKeithen*, 395 U.S. 411 (1969), reh.den. 396 U.S. 869 (1969) and *Conley* v. *Gibson*, 355 U.S. 41 (1957).

The Allegations Of The Counterclaim

It will be appropriate to understanding the issues presented to the Court in connection with defendants' motion to dismiss the Counterclaim if the material allegations of the Counterclaim are reviewed. For the present purpose, the Counterclaim substantially alleges as follows:

> For many years Harvester owned and operated a steel mill located on the south side of Chicago (the Steel Mill),

as well as ancillary facilities including a railroad, ore vessel, a coal mine and iron mining interests. From 1970 through June, 1977, Harvester's yearly losses in operating the Steel Mill increased from $590,000 to more than $18 million. As a result, starting in 1973, Harvester unsuccessfully tried to sell the Steel Mill and related assets.

In 1977, Harvester determined that it would suffer a loss of $167 million if it closed and terminated its operation of the Steel Mill, including its unfunded pension obligations of $86 million. (The Counterclaim alleges $138 million in losses but the sum of $167 million is contained in exhibits attached to the affidavits filed in connection with the motion for summary judgment.) Alternatively, Harvester determined that if it continued to operate the Steel Mill it would be required to spend at least $123 million merely to prevent the further physical deterioration of the Steel Mill and to correct pending environmental problems. Earlier, in 1975, Harvester had determined that it would have to make capital expenditures of at least $150 million for improvements and rehabilitation in order that the steel operations might become profitable.

In 1977, Harvester offered to sell the Steel Mill and related assets to EDC Holding Company (EDC) in a secured, leveraged transaction without any investment or obligation on the part of EDC's parent corporation, Envirodyne Industries, Inc. (Envirodyne). EDC was a thinly capitalized subsidiary of Envirodyne. Neither Envirodyne nor EDC had been in the steel business, had any meaningful assets or earnings or had the financial capability of raising the funds necessary to operate or rehabilitate the Steel Mill. As a condition to the sale, Harvester required EDC to execute a long-term supply contract with Harvester whereunder Harvester would be supplied, among other things, with certain steel products produced only by the Steel Mill.

Harvester made information available to Envirodyne upon which Envirodyne projected the future operations, capital needs and profitability of the operations. Upon the information supplied by Harvester, Envirodyne projected that it would immediately reverse the prior years' successively increasing losses of the Steel Mill and would realize immediate profits and would be required to invest for capital improvements and rehabilitation barely one-half of the amounts of funds which Harvester had determined to be necessary for such purposes. In its projections, Envirodyne provided that EDC would be required to assume and spend only $60 million to satisfy Harvester's unfunded pension liabilities, although Harvester knew that the correct amount of its unfunded pension obligations was more than $86 million. Harvester did not reveal to Envirodyne, EDC or any of the creditors of these estates the actual facts known to Harvester about the investment required to rehabilitate the Steel Mill, the actual amount of its unfunded pension liabilities or several other improper assumptions included in Envirodyne's operating projections.

Chase Manhattan Bank (Chase) agreed to provide EDC with limited financing to acquire the Steel Mill if Chase's loan were fully collateralized by the accounts receivable and steel inventories of the Steel Mill and also if an undertaking was obtained from Philip Brothers to purchase those inventories. Chase insisted upon those conditions being met so that Chase would not have to rely upon the profitability of the Steel Mill operations for payment of its loan. Harvester knew that the amount of financing offered by Chase was inadequate to enable EDC to operate and rehabilitate the Steel Mill.

At Harvester's request, Lehman Brothers (Lehman), investment bankers, analyzed the proposed sale and Envirodyne's projections and advised Harvester, among

other things, that it was extremely doubtful that EDC could operate the Steel Mill without outside financing, that outside financing did not appear to be available, that EDC did not have the capacity to finance the needed capital and that it was extremely doubtful that EDC would be able to pay Harvester the future deferred installments of the purchase price. Lehman recommended that Harvester make further efforts to find a financially stronger purchaser with steel industry experience to assume Harvester's steel operations and unfunded pension liabilities.

Harvester had calculated its losses at $167 million if it closed the Steel Mill and projected that it would save $70 million if it sold its steel operations to EDC and EDC went bankrupt in two years. Lehman advised Harvester that Harvester's calculations did not take into account either the legal problems Harvester would experience in realizing upon its security interest or "the exposure of Harvester to creditors of EDC . . . [from] . . . possible lawsuits . . . on the basis that the transaction is primarily a device to avoid the Company's liabilities."

Disregarding Lehman's report, Harvester consummated the sale to EDC and the other debtors in these cases. All accounts receivable and steel inventories were pledged to Chase for a loan of $35 million, $15 million of which was paid to Harvester in cash. All of the remaining assets of the steel operation acquired by the debtors were pledged to Harvester as collateral to secure payment to Harvester of the $50 million in promissory notes issued to Harvester and the debtors' payment of all of Harvester's steel operation obligations, including its unfunded pension liabilities.

The debtors suffered immediate operating losses aggregating $5 million in the five months after consummation of the sale and more than $17 million in 1978. During the same period, the debtors paid to or for Harvester's benefit almost $33 million in cash. Also

during that period, Harvester failed to purchase steel products from the debtors in the amounts required by its supply contract. The debtors were unable to borrow money from any source other than Harvester.

At the debtors' request, Harvester loaned the debtors $10 million on the condition that the debtors deliver to Harvester title to the coal mine and iron mining interests, which were the debtors only valuable assets. In that way, Harvester intended to obtain for itself and deprive the creditors of these estates of the debtors' only assets of any significant value.

Harvester expected its union employees to go on strike in the fall of 1979 for an extended period of time and Harvester believed that such a strike would destroy the ability of the debtors to continue their operations. Harvester, therefore, accelerated its purchases of the unique products which it required and which it could obtain only from the debtors so that Harvester would have adequate supplies of those parts on hand after the debtors ceased operations because of the anticipated strike and until Harvester could arrange alternate sources of supply. Two months after the strike began, at the end of 1979, Harvester stopped purchasing any products from the debtors.

During early 1980, the debtors were unable to pay the debts related to their iron mining interests, payment of which debts had been guaranteed by Harvester. To provide for payment of its obligations from the debtors' assets, Harvester purchased iron ore pellets from the debtors on the condition that the sale proceeds would be used by the debtors to pay the debts guaranteed by Harvester. The pellets purchased by Harvester had a market value of more than $11 million, but Harvester paid the debtors only $7.5 million therefor. Those purchases were made while the debtors were insolvent and constituted fraudulent transfers.

In February and March of 1980, the debtors informed Harvester that they could not continue operating the Steel Mill and pay their employees without Harvester's further financial assistance. The debtors told Harvester that if such financial assistance was not provided, they would discharge their employees rather than permit them to work and not be paid. Harvester urged the debtors to continue their operations and, on March 27, 1980, without prior notice, Harvester took absolute ownership of the debtors' coal mine and iron mining interests and withdrew its financial support from the debtors. Upon learning of Harvester's acts, Chase set off and applied the funds in the debtors' accounts in payment of the Chase loan thereby causing the debtors' employees' paychecks to be dishonored. The debtors were then compelled to file these chapter 11 cases.

WSC further alleges that Harvester's foregoing actions were in furtherance of Harvester's concerted plan to dispose of the Steel Mill in order that Harvester might avoid the enormous financial losses and stigma of closing the Steel Mill, avoid the huge costs and losses of its continued operation, withdraw and retain for itself as much cash and other assets of its steel operations as possible to the exclusion of creditors when the debtors became bankrupt and effectively to retain the Steel Mill as long as possible as a captive source of supply of the unique parts which it manufactured and which were essential to Harvester's other operations. WSC also alleges that all such actions by Harvester were part of its secret plan to shift the costs, debts and losses incident to closing the Steel Mill to the creditors of these estates while Harvester withdrew for itself as much of the cash and other valuable steel related assets as possible, thereby leaving the Steel Mill creditors unpaid.

Contentions Of The Parties

WSC concedes that although this may be a case of first impression, the facts alleged require the equitable subordination of Harvester's claim and its liens on the debtors' coal and iron mining interests. WSC further argues that said facts create liability of Harvester for the debts owing to the creditors of these estates because of the doctrines of unconscionable and inequitable conduct, violation of the Illinois Fraudulent Transfer Act and common law tort.

Defendants argue in substance that no cause of action is alleged because they had neither any duty to volunteer any opinions, nor any duty to disclose anything to the creditors of these estates. Defendants also contend that WSC, in this exercise of the rights and powers of a trustee in bankruptcy, has no standing under § 544 of the Bankruptcy Code to assert a right of recovery for a violation of the Illinois Fraudulent Transfer Act.

Discussion

The foregoing recitation constitutes a summary of the principal allegations of the Counterclaim and the contentions of the parties and does not represent any findings or conclusions by the court. However, the allegations of the Counterclaim, if proved, establish a preconceived intentional plan by Harvester to dispose of the Steel Mill in a manner to evade the liabilities and costs of either operating or closing the Steel Mill, to shift and unload those losses, liabilities and costs upon the creditors of these estates, and, at the same time, to obtain for itself substantial amounts of cash as well as the most valuable assets of the steel operation. Those allegations, if proved, establish Harvester's actual intent to hinder, delay, defraud and injure the thousands of employees and other creditors of the debtors existing when the debtors went bankrupt. Those creditors have filed claims in these cases for amounts well in excess of $100 million.

If the allegations of the Counterclaim are proved, Harvester's conduct was demonstrably inequitable and unconscionable and resulted in clear harm and financial damage to the creditors of these estates, and would compel equitable subordination of Harvester's claim and liens to the claims of the other creditors herein. *Pepper* v. *Litton*, 308 U.S. 295 (1939); *Heiser* v. *Woodruff*, 327 U.S. 726 (1946); *In re Westgate-California Corp.*, 642 F.2d 1174 (9th Cir. 1981); *In re Multiponics, Inc.*, 622 F.2d 709 (5th Cir. 1980); and *Gannett* v. *Larry*, 221 F.2d 269 (2d Cir. 1955). Proof of such conduct would also establish Harvester's liability for the debts of these estates. *Henderson* v. *Rounds & Porter Lumber Co.*, 99 F.Supp. 376 (W.D.Ark. 1951); *Gulf Oil Trading Co.* v. *Creole Supply*, 596 F.2d 515 (2d Cir. 1979); and *Krivo Industrial Sup. Co.* v. *National Distill. & Chem. Corp.*, 483 F.2d 1098 (5th Cir. 1973).

The allegations of the Counterclaim which, for the purposes of the motion to dismiss, must be taken as admitted, further establish that Harvester effected the sale to the debtors with the expectation of injuring the creditors of these estates by leaving them unpaid upon the financial failure and bankruptcy of the debtors. Such intentional conduct is tortious. *Tillman* v. *Wheaton-Haven Recreation Ass'n., Inc.*, 517 F.2d 1141 (4th Cir. 1975); *Caldwell* v. *Bechtel, Inc.*, 631 F.2d 989 (D.C. Cir. 1980); *Laflin* v. *Estate of Mills*, 53 Ill.App. 3d 29 (1977); and 74 *Am. Jur. 2d Torts*, § 10, p. 628.

Harvester's conduct, if proved as alleged, would also violate the Illinois Fraudulent Transfer Act, 59 Ill.Rev.Stat. § 4, which provides:

> "Every gift, grant, conveyance, assignment or transfer of, or charge upon any estate, real or personal, or right or thing in action, or any rent or profit thereof, made with the intent to disturb, delay, hinder or defraud creditors or other persons, and every bond or other evidence of debt given, suit commenced, or judgment entered, with like intent, shall be void as against such creditors, purchasers and other persons."

Whether the creditors of these estates are deemed, for purposes of the Illinois statute, to be Harvester's creditors as they would have been had Harvester retained and closed the Steel Mill, or whether they are deemed to be "other persons", it appears clear that they must be "creditors" or "other persons" whom the statute intended to protect.

Defendants contend that WSC may not sue for a violation of the Illinois Fraudulent Transfer Act because no property of the debtors was transferred to Harvester. The Counterclaim alleges, however, that Harvester did receive transfers of cash, iron ore pellets, security interests and mortgages from and on the property of the debtors. Those transfers were an integral part of the overall plan alleged to have been created and implemented by Harvester. Since the entire plan and each of its components violated the Illinois Fraudulent Transfer Act and since many of those components did involve transfers of property by the debtors, defendants' argument must be rejected. WSC may sue under § 544(b) of the Bankruptcy Code, 11 U.S.C. § 544(b). Also, § 544(a) of the Bankruptcy Code, 11 U.S.C. § 544(a), authorizes WSC to assert all of the rights of a judicial lien creditor or execution creditor of the debtors. Such a creditor may also assert claims against Harvester under the Illinois Fraudulent Transfer Act. There is, therefore, legal basis for WSC to sue Harvester under § 544 of the Bankruptcy Code for a violation of the Illinois Fraudulent Transfer Act.

WSC also alleges that the individual defendants, directors and officers of Harvester, with knowledge of the facts alleged, authorized Harvester's actions and participated therein. On oral argument, counsel for the individual defendants acknowledged that the individual defendants voted for the sale. Neither in their memoranda in support of their motion to dismiss nor during oral argument, despite the inquiries of the Court, did the individual defendants contend that even if the Counterclaim states a claim against Harvester, it nevertheless does not state a claim against the individual defendants. Since it is alleged that the individual

defendants, with full knowledge of all facts, voluntarily and intentionally voted for the sale and authorized Harvester to implement its plan, the Counterclaim states a claim for relief against the individual defendants. *Tillman v. Wheaton-Haven Recreation Ass'n., Inc.*, 517 F.2d 1141 (4th Cir. 1975); *Lowell Hoit & Co.* v. *Detig*, 50 N.E. 2d 602 (2d Dist. 1943); *Independence Tube Corp.* v. *Copperweld Corp.*, 74 F.R.D. 462 (N.D.Ill. 1977); and, *Solo Cup Co.* v. *Paper Machinery Corp.*, 359 F.2d 754 (7th Cir. 1966).

Taking the allegations of the Counterclaim as admitted for purposes of defendants' motion to dismiss, it appears clear that WSC has stated facts which, if proved by competent evidence, would entitle it to relief. Accordingly, defendants' motion to dismiss must be denied and WSC must be afforded the opportunity to prove its very serious allegations convincingly by competent evidence.

IT IS THEREFORE ORDERED that defendants' motion to dismiss be and it is hereby denied.

It Further Ordered that the defendants answer the plaintiffs' counterclaim within 45 days.

It is Further Ordered that a status hearing be and it is set for January 19, 1983 at 11:00 A.M.

Dated: November 18, 1982

ENTER:

/s/ CHARLES B. MCCORMICK
U.S. Bankruptcy Judge

In The

United States District Court

FOR THE NORTHERN DISTRICT OF ILLINOIS

EASTERN DIVISION

WSC CORPORATION AND ALL OF THE OTHER DEBTORS IN POSSESSION, **Plaintiff,** **vs.** **INTERNATIONAL HARVESTER, et al.,** **Defendant.**	No. 82 C 7440 Before the Honorable **George N. Leighton** United States District Judge

Memorandum

This cause is before the court on two motions by defendants: the first, an application for leave to appeal from an order entered by the bankruptcy court on November 18, 1982, denying defendants' motion to dismiss Counts I through IV of plaintiffs' amended counterclaim; the other, a motion to dismiss the amended counterclaim on grounds that the bankruptcy court and this court lack jurisdiction over its subject matter. For the following reasons, the application for leave to appeal is denied, and the motion to dismiss will not be considered.

It is apparent from the submissions of the parties that the bankruptcy court's order is interlocutory; no final order determining the rights of any party has been entered. Therefore, there is no federal statute obligating this district court to review the bankruptcy judge's decision. *Roslyn Sav. Bank* v. *Vaniman Intern., Inc.*, 8 B.R. 751 (E.D. N.Y. 1981). Whether to review an interlocutory order of the bankruptcy

court is a matter committed to the sound discretion of the district court. *See Beatty* v. *Esposito*, 411 F.Supp. 107 (E.D. N.Y. 1976); 28 U.S.C. § 1334. In the interest of promoting the efficacious resolution of proceedings in the bankruptcy court, district courts generally elect to review interlocutory bankruptcy orders only where exceptional circumstances are presented. *Id.* After carefully reviewing the submissions of the parties, the court concludes that this case does not present exceptional circumstances justifying interlocutory review and denies the application for leave to appeal. Consequently, the court will not consider defendants' motion to dismiss the amended counterclaim for lack of jurisdiction; this cause remains in the bankruptcy court.

So ordered,

s/ GEORGE N. LEIGHTON
George N. Leighton,
United States District Judge

January 7, 1983

STATEMENT

OF

MURRAY DRABKIN, ESQ.

BEFORE THE

SUBCOMMITTEE ON MONOPOLIES AND

COMMERCIAL LAW

COMMITTEE ON THE JUDICIARY

HOUSE OF REPRESENTATIVES

ON

H.R. 3

THE BANKRUPTCY COURT ACT OF 1983

FEBRUARY 2, 1983

Mr. Chairman and Members of the Subcommittee:

I am honored by your invitation to address the Subcommittee in regard to H.R. 3—the Bankruptcy Court Act of 1983—and the problems to which it is directed.

By way of introduction, I am a member of the law firm of Cadwalader, Wickersham & Taft, where I head the firm's bankruptcy and reorganization practice. This practice is nationwide and I am currently involved in bankruptcy proceedings in some ten states. I am a member of the National Bankruptcy Conference, the Committee on Bankruptcy and Reorganization of the Association of the Bar of the City of New York and the Bankruptcy Committee of the D.C. Bar. I have served as general counsel to the National Conference of Bankruptcy Judges and took an active role in the formulation of the Bankruptcy Reform Act of 1978.

You may recall, Mr. Chairman, that from 1957 to 1965 I served as counsel to what was then called Subcommittee #4 of this Committee—the Subcommittee on Bankruptcy and Reorganization. There I was indoctrinated into the metaphysical distinctions between plenary and summary jurisdiction and became familiar with the gross inadequacies of bankruptcy court jurisdiction under the old system. Some twenty years later, in 1978, after a massive effort and the most painstaking study imaginable, Congress acted to resolve those problems by providing the pervasive jurisdiction required for the effective functioning of the court. But here we sit confronting those problems once again, this time in yet another form.

The situation in which the bankruptcy courts find themselves today is a disgrace. The court system established by the 1978 Act is out of business. It has been replaced by a so-called Emergency Rule promulgated by the Judicial Conference for adoption by each district court as a local rule. The Emergency Rule can be justified only by the Armageddon principle—its operation staves off total collapse. To that extent, the Emergency Rule has short-term value. However,

it is no permanent solution and the difficulties and the dangers it presents are deeply troublesome.

The constitutionality of the Rule itself is doubtful. Already we have a split among reported decisions dealing with the issue. Furthermore, there is not only the fundamental question of whether the judicial branch may confer jurisdiction where Congress could not, but there are narrower constitutional issues in regard to specific proceedings under the Rule. Until *all* of those issues are resolved, the certainty essential to the conduct of commercial transactions will be missing. I suspect that some of those issues will not have been resolved by the time the Rule expires by its own terms in 1984.

The difficulties to which I allude are real, and have become an epidemic in the brief period since the *Marathon* stay expired. In preparation for this hearing, I canvassed various bankruptcy experts around the country and asked them for their experiences under the Rule. They report widespread constitutional challenges to the jurisdiction of the bankruptcy judge, and in some instances of the district judge as well. I was told that in one district, Utah, not a single bankruptcy case of any significance has been tried since the first of the year as a result of jurisdictional objections.

In another district, in Texas, the issue has taken the form, not of a frontal attack upon jurisdiction, but rather of repeated confrontations on the question of whether a specific matter "arises under" or is "related to" for purposes of determining whether it should be handled by the district judge or by the bankruptcy judge. In most instances, the Texas bankruptcy judge has concluded that he cannot classify which it is. Equally troublesome, he has found, is the situation where the matter both "arises under" and is "related to".

In many districts, certification to the district judge is frequently demanded by parties uncertain as to the authority of the bankruptcy judge to issue particular kinds of orders. These include financing orders, confirmations and

approvals of compromises. Even with the signature of the district judge, there is sometimes insufficient jurisdictional certainty as, for example, in the following case from Texas. A subsidiary in chapter 11 owned real property, the sale of which was critical to its success and to keeping its parent out of bankruptcy. A complaint to sell the property free of liens was filed and there being no objection, an order approving the sale was signed by the bankruptcy judge. Upon request, the order was certified to the district judge for his approval and signature. Nevertheless, the title company refused to issue the necessary title policy because of its concern about the constitutional validity of the order, and said it would do so only upon the signature of all equity holders and all persons holding security interests in the property.

In some areas, the uncertainty apparently has halted the doing of necessary business. In a district in which there is normally a great deal of commercial activity, the bankruptcy judge reports that he has not seen a single financing order since the *Marathon* stay expired. Other bankruptcy judges report a flurry of challenges to their general powers or to their authority to issue particular orders. One bankruptcy judge in California reports being bombarded with motions to abstain on the ground of lack of jurisdiction, with the result that many matters end up in the district court. In another district, the bankruptcy judge reports having certified four matters to the district judge: two involving post-petition creditors seeking a super priority, who insisted on approval by the district judge; one in which a post-confirmation lender insisted on approval of confirmation by the district judge; one in which a party insisted on having a compromise of a claim approved by the district judge. Some three weeks after referral, the district judge had not acted on any of these requests and it is believed that the lender in one of the cases has now withdrawn.

To be sure, there are also reports of district judges responding promptly. However, it has become clear that all too

frequently they are affixing their signatures to orders previously approved by bankruptcy judges without the slightest indication of independent evaluation.

The examples I have cited are just that—examples of what is happening around the country. In spite of these difficulties, there is the question of whether the system is nevertheless working. That, of course, depends upon how one defines "working". To the extent that it is working, it is working because people—lawyers, bankruptcy judges, district judges—want to avoid a total breakdown. In many districts, lawyers and judges who know very well that the system has real problems are acting as if it did not, in the hope that everything will somehow work out.

It would be a serious mistake, however, for Congress to be lulled into a sense of indifference or complacency based on the present situation. There may be very little sound or drama as one sinks gradually into a quagmire, and that is exactly what is happening to the bankruptcy system today.

First, the district courts have yet to feel the brunt of the so-called "related cases" which under the Rule are the primary responsibility of the district judge. District court calendars which already are overcrowded will become even more congested with cases that should be decided by a judge who is experienced in the field of bankruptcy.

Second, irreparable harm is being done to the functioning of the bankruptcy system by the continuing demoralization of the nation's corps of bankruptcy judges, as evidenced by recent further resignations, including the announced departures of two of the most prominent and highly regarded, Judge Dean Gandy of Dallas and Judge Herbert Katz of Los Angeles. Judges do not wish to spend their lives listening to arguments about where cases should be tried. They feel that bankruptcy proceedings should be concerned with the merits and not endless disputes about jurisdiction.

Third, the dramatic problems in the system, such as those I have described, are merely the outward signs of the really devastating diversions of energy and resources which are

required simply to cope with the jurisdictional mess. In my own practice, I can attest to hundreds of hours devoted to work which would not be required if there were an Article III court. Thus, for example, in one chapter 11 case, on behalf of the trustee, we brought complaints in the bankruptcy court to recover preferential payments from several hundred creditors. However, because of jurisdictional uncertainties in the face of the imminent expiration of the relevant statute of limitations, we felt obliged to file similar complaints in the district court. I have heard of other lawyers advising their clients to file not only in the bankruptcy and district courts but also in state courts.

To go to such lengths to preserve one's rights under the Code is, unfortunately, not the product of excessive caution. In *Nucorp,* one of the largest chapter 11's presently pending, the debtor had filed actions in the bankruptcy court to recover some ten to fifteen million dollars in receivables and preferences. The deluge of objections by defendants to the jurisdiction of the court has caused *Nucorp* to begin dismissing these actions and to bring them in state courts and in federal district courts. Instead of one court and one set of lawyers, the debtor now is confronted with the old problem of having to maintain actions in numerous courts with a multitude of law firms, all at substantial additional cost in time and money.

If, in the midst of this confusing, wasteful, duplicative mess, one takes a moment to ask "Why?" the answer is devastating. The answer, I am afraid, is that the only purpose which all this waste serves is to avoid giving to the bankruptcy judges the constitutional status which this Committee in 1978 determined was necessary if they were to conduct the business of the bankruptcy courts in the most efficient manner. Accordingly, Mr. Chairman, I conclude my statement by congratulating you and the Committee for your steadfast position on this issue. Like virtually every other professional who daily deals with the bankruptcy process, I fully endorse the provisions of H.R. 3 with respect to the structure and constitutional status of the bankruptcy court and hope for its speedy enactment.

TEXT OF STATUTES AND RULES

Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, § 241(a), 92 Stat. 2549, 2668 (1978), provides in relevant part:

> Title 28 of the United States Code is amended by inserting immediately after chapter 89 the following:
>
> § 1471. *Jurisdiction*
>
> (a) Except as provided in subsection (b) of this section, the district courts shall have original and exclusive jurisdiction of all cases under title 11.
>
> (b) Notwithstanding any Act of Congress that confers exclusive jurisdiction on a court or courts other than the district courts, the district courts shall have original but not exclusive jurisdiction of all civil proceedings arising in or related to cases under title 11.
>
> (c) The bankruptcy court for the district in which a case under title 11 is commenced shall exercise all of the jurisdiction conferred by this section on the district courts.

Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, § 401, 92 Stat. 2549, 2682 (1978), provides in relevant part:

> Sec. 401(a). The Bankruptcy Act is repealed.

Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, § 404, 92 Stat. 2549, 2683-2685 (1978), provides in relevant part:

> **COURTS DURING TRANSITION**
>
> Sec. 404(a). The courts of bankruptcy, as defined under section 1(10) of the Bankruptcy Act, created under section 2a of the Bankruptcy Act, and existing on September 30, 1979, shall continue through March 31, 1984, to be the courts of bankruptcy for the purposes of this Act and the amendments made by this Act. Each of the courts of bankruptcy so continued shall constitute

a separate department of the district court that is such court of bankruptcy under the Bankruptcy Act.

Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, §405, 92 Stat. 2549, 2685 (1978), provides in relevant part:

(c)(2) During the transition period, the jurisdiction of the district courts, the courts of appeals, and panels of bankruptcy judges to hear appeals shall be the same as the jurisdiction of such courts and panels granted under the amendments made by sections 236, 237, 238, and 241 of this Act to hear appeals from the judgments, orders, and decrees of the bankruptcy courts established under section 201 of this Act.

11 U.S.C. §105, provides in relevant part:

The bankruptcy court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title.

28 U.S.C. § 332(d) provides:

(1) Each judicial council shall make all necessary and appropriate orders for the effective and expeditious administration of justice within its circuit. Each council is authorized to hold hearings, to take sworn testimony, and to issue subpoenas and subpoenas duces tecum. Subpoenas and subpoenas duces tecum shall be issued by the clerk of the court of appeals, at the direction of the chief judge of the circuit or his designee and under the seal of the court, and shall be served in the manner provided in rule 45(c) of the Federal Rules of Civil Procedure for subpoenas and subpoenas duces tecum issued on behalf of the United States or an officer or agency thereof.

(2) All judicial officers and employees of the circuit shall promptly carry into effect all orders of the judicial council.

(3) Unless an impediment to the administration of justice is involved, regular business of the courts need not be referred to the council.

28 U.S.C. §1331 provides:

The district courts shall have original jurisdiction of all civil actions arising under the Constitution, laws, or treaties of the United States.

28 U.S.C. § 1332 provides in relevant part:

(a) The district courts shall have original jurisdiction of all civil actions where the matter in controversy exceeds the sum or value of $10,000, exclusive of interest and costs, and is between—

(1) citizens of different States:

(2) citizens of a State, and foreign states or citizens or subjects thereof; and

(3) citizens of different States and in which foreign states or citizens or subjects thereof are additional parties.

28 U.S.C. § 1334 (effective date Apr. 1, 1984) [referred to as new 28 U.S.C. § 1334], provides:

§ 1334. Bankruptcy appeals

(a) The district courts for districts for which panels have not been ordered appointed under section 160 of this title shall have jurisdiction of appeals from all final judgments, orders, and decrees of bankruptcy courts.

(b) The district courts for such districts shall have jurisdiction of appeals from interlocutory orders and decrees of bankruptcy courts, but only by leave of the district court to which the appeal is taken.

(c) A district court may not refer an appeal under that section to a magistrate or to a special master.

28 U.S.C. § 1334 [referred to as old 28 U.S.C. § 1334], provides:

> The district courts shall have original jurisdiction exclusive of courts of the States, of all matters and proceedings in bankruptcy.

28 U.S.C. § 1651(a) provides:

> The Supreme Court and all courts established by Act of Congress may issue all writs necessary or appropriate in aid of their respective jurisdictions and agreeable to the usages and principles of law.

Rule 26 of the Rules of the Supreme Court provides:

> The issuance by the Court of any extraordinary writ authorized by 28 U.S.C. § 1651(a) is not a matter of right, but of discretion sparingly exercised. To justify the granting of any writ under that provision, it must be shown that the writ will be in aid of the Court's appellate jurisdiction, that there are present exceptional circumstances warranting the exercise of the Court's discretionary powers, and that adequate relief cannot be had in any other form or from any other court.

Rule 53 of the Federal Rules of Civil Procedure provides in relevant part:

> (b) *Reference.* A reference to a master shall be the exception and not the rule. In actions to be tried by a jury, a reference shall be made only when the issues are complicated; in actions to be tried without a jury, save in matters of account and of difficult computation of damages, a reference shall be made only upon a showing that some exceptional condition requires it.
>
> (e) (2) *In Non-Jury Actions.* In an action to be tried without a jury the court shall accept the master's findings of fact unless clearly erroneous. Within 10 days after being served with notice of the filing of the report any party may serve written objections thereto upon the

other parties. Application to the court for action upon the report and upon objections thereto shall be by motion and upon notice as prescribed in Rule 6(d). The court after hearing may adopt the report or may modify it or may reject it in whole or in part or may receive further evidence or may recommit it with instructions.

Rule 82 of Federal Rules of Civil Procedure provides in relevant part:

> These rules shall not be construed to extend or limit the jurisdiction of the United States district courts or the venue of actions therein.

Rule 83 of Federal Rules of Civil Procedure provides in relevant part:

> Each district court by action of a majority of the judges thereof may from time to time make and amend rules governing its practice not inconsistent with these rules. Copies of rules and amendments so made by any district court shall upon their promulgation be furnished to the Supreme Court of the United States. In all cases not provided for by rule, the district courts may regulate their practice in any manner not inconsistent with these rules.

Rule 513 of the Rules of Bankruptcy Procedure provides:

> If a reference is made in a bankruptcy case by a judge to a special master, the Federal Rules of Civil Procedure applicable to masters apply.

Rule 927 of the Rules of Bankruptcy Procedure provides:

> Each district court by action of a majority of the judges thereof may from time to time make and amend rules governing practice and procedure under the Act not inconsistent with these rules. Copies of rules and amendments so made shall upon their promulgation be furnished to the Administrative Office of the United

States Courts. The clerk of each court shall make appropriate arrangements, subject to the approval of the Director of the Administrative Office of the United States Courts, for making copies of such rules available to members of the public who may request them. In all cases not provided for by rule, the district court may regulate its practice in any manner not inconsistent with these rules.

Rule 928 of the Rules of Bankruptcy Procedures provides:

> These rules shall not be construed to extend or limit the jurisdiction of courts of bankruptcy over subject matter.